NAVAL POSTGRADUATE SCHOOL
MONTEREY, CALIFORNIA

THESIS

PROMOTING ECONOMIC DEVELOPMENT IN AMERICA'S INNER CITIES WITH FEDERAL CONTRACTING INCENTIVES

by

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September 1997

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REPORT DOCUMENTATION PAGE			Form Approved OMB No. 0704-0188
Public reporting burden for this collection of information is estimated to average 1 hour per response, including the time for reviewing instruction, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Washington Headquarters Services, Directorate for Information Operations and Reports, 1215 Jefferson Davis Highway, Suite 1204, Arlington, VA 22202-4302, and to the Office of Management and Budget, Paperwork Reduction Project (0704-0188) Washington DC 20503.			
1. AGENCY USE ONLY *(Leave blank)*	2. REPORT DATE September 1997	3. REPORT TYPE AND DATES COVERED Master's Thesis	
4. TITLE AND SUBTITLE PROMOTING ECONOMIC DEVELOPMENT IN AMERICA'S INNER CITIES WITH FEDERAL CONTRACTING INCENTIVES.			5. FUNDING NUMBERS
6. AUTHOR(S) Torres, Guy A.			
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) Naval Postgraduate School Monterey CA 93943-5000			8. PERFORMING ORGANIZATION REPORT NUMBER
9. SPONSORING/MONITORING AGENCY NAME(S) AND ADDRESS(ES)			10. SPONSORING/MONITORING AGENCY REPORT NUMBER
11. SUPPLEMENTARY NOTES: The views expressed in this thesis are those of the author and do not reflect the official policy or position of the Department of Defense or the U.S. Government.			
12a. DISTRIBUTION/AVAILABILITY STATEMENT Approved for public release; distribution is unlimited.			12b. DISTRIBUTION CODE

13. ABSTRACT *(maximum 200 words)*

For over 30 years, the United States has faced the challenge of revitalizing its deteriorating urban communities. Throughout the 1980s and early 1990s, U.S. policymakers have shown an interest in geographically targeted urban economic development strategies, specifically in the form of Enterprise Zones. Now renamed Empowerment Zones, these are sections of poverty-stricken communities in which the Government hoped to promote economic development by providing businesses with incentives to locate in the zones. These Empowerment Zones primarily used tax incentives to convince businesses to relocate. Studies revealed that this approach to attracting businesses to the targeted region has met with minimal success.

In the past two years, U.S. policymakers have proposed two initiatives that use the Federal procurement system as a means to incentivize firms to locate into economically distressed urban and rural areas. This study analyzes the Federal Government's recent initiatives to stimulate economic development in America's inner cities with Federal contracting incentives. It answers questions surrounding the potential economic impact of such initiatives on the inner city. Lastly, the study recommends alternative policy approaches to applying Federal contracting incentives to create jobs and spur business investment in America's inner cities.

14. SUBJECT TERMS Empowerment Zone Concept, Empowerment Contracting Program, HUBZone Act of 1997, Federal Contracting Preferences and Set-Asides			15. NUMBER OF PAGES 117
			16. PRICE CODE
17. SECURITY CLASSIFICATION OF REPORT Unclassified	18. SECURITY CLASSIFICATION OF THIS PAGE Unclassified	19. SECURITY CLASSIFICATION OF ABSTRACT Unclassified	20. LIMITATION OF ABSTRACT UL

NSN 7540-01-280-5500

Standard Form 298 (Rev. 2-89)
Prescribed by ANSI Std. 239-18 298-102

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PROMOTING ECONOMIC DEVELOPMENT IN AMERICA'S INNER CITIES WITH FEDERAL CONTRACTING INCENTIVES

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Submitted in partial fulfillment
of the requirements for the degree of

MASTER OF SCIENCE IN MANAGEMENT

from the

NAVAL POSTGRADUATE SCHOOL
September 1997

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ABSTRACT

For over 30 years, the United States has faced the challenge of revitalizing its deteriorating urban communities. Throughout the 1980s and 1990s, U.S. policymakers have shown an interest in geographically targeted urban economic development strategies, specifically in the form of Enterprise Zones. Now renamed Empowerment Zones, these are sections of poverty-stricken communities in which the Government hoped to promote economic development by providing businesses with incentives to locate in the zones. These Empowerment Zones primarily used tax incentives to convince businesses to relocate. Studies revealed that this approach to attracting businesses to the targeted region has met with minimal success.

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I. INTRODUCTION

A. BACKGROUND

For over 30 years, the United States has faced the challenge of revitalizing its deteriorating urban communities. In the past, the Federal Government has tried to revive distressed areas by providing grants for activities ranging from job training and social services to the repair and replacement of aging infrastructure. Throughout the 1980s and early 1990s, U.S. policymakers have shown interest in geographically targeted urban economic development strategies, specifically in the form of Enterprise Zones. A concept originating in England, these zones captured the imagination of U.S. Federal Government policymakers in the early 1980s as a potentially powerful strategy for promoting economic development in pockets of urban areas. [Ref. 1:p. 193] Empowerment Zones (formerly known as Enterprise Zones) are sections of poverty-stricken communities in which the Government hopes to promote economic development by providing businesses with incentives to locate in the zones. These Empowerment Zones (EZs) primarily used tax incentives to convince businesses to relocate. The focus on tax incentives was partly due to the political leadership of the times, who wished to reduce taxes across the board. [Ref. 2:p. 1] Unfortunately, recent studies of past EZs failed to illustrate that tax incentives could significantly impact economic development in urban communities.

In an effort to improve the performance of the Empowerment Zone program, President Clinton, in the Spring of 1993, committed his administration to the successful implementation of the EZ program. President Clinton's EZ program represents a distinct

departure from past attempts to revitalize economic development in urban areas of the nation. One of the most significant changes was to broaden the range of incentives offered to businesses located in the Zone, adding non-tax incentives to the tax incentives typically offered in the past. [Ref. 2:p. 2]

President Clinton on May 21, 1996, signed Executive Order 13005, The Empowerment Contracting Program, which made the Federal Government a more effective partner in promoting jobs and private-sector investment in America's distressed inner city and rural communities.

This executive order on Federal contracting launched the President's Empowerment Contracting Program, providing a supplement to, not a replacement for, existing Federal procurement programs. The program offers special incentives for Government contracting awards to businesses in distressed communities. Under the empowerment contracting order, large or small businesses that hire a significant number of the residents and that will generate significant economic activity in low-income areas will be eligible to participate in the program.

In an effort to create jobs and stimulate new business investment in America's urban and rural communities, Senator Christopher Bond (R-MO), Chairman of the Senate Committee on Small Business, on January 28, 1997, introduced the HUBZone Act of 1997 (S.208) to Congress. The Act is an aggressive legislative initiative designed to stimulate the economic development of America's most disadvantaged urban and rural communities. Bond's goal is to have new Government contracts be awarded to small businesses in economically distressed areas.

B. OBJECTIVE OF THE RESEARCH

This research effort analyzes the recent Federal Government initiatives to stimulate economic development in the inner cities of America with federal contracting incentives. It attempts to answer questions surrounding the potential impact of such initiatives based upon the information gathered from phone-interview surveys and the latest available information on urban economic development policies and efforts. The research also recommends policy-making alternatives to applying Federal contracting incentives in the most effective way to promote economic development in urban communities of America based upon the strengths of the latest initiatives, the results of the surveyed material, and the latest literature gathered for this study.

C. RESEARCH QUESTIONS

1. Primary Research Question

Will Federal contracting incentives significantly impact economic development in America's inner cities?

2. Subsidiary Research Questions

- How is economic development defined?
- What is a HUBZone?
- What is an Empowerment Zone?
- How does the HUBZone Act differ from President Clinton's Empowerment Contracting Program?
- What barriers do these programs face in attempting to stimulate economic development in the inner city?

- What other factors besides contracting incentives might attract businesses to relocate to the inner city?
- What roles should the Federal Government and local government play in fostering economic development in the inner cities with Federal contracting incentives?
- What roles should private sector and community based organizations play in fostering economic development in the inner cities with Federal contracting incentives?

D. SCOPE

The scope of the study is to provide information, analysis, and conclusions on the issue of promoting economic activity in America's inner cities with Federal contracting incentives. This is a fairly new method of promoting economic activity in the inner city. There have not been any studies done on the status of using this non-tax incentive as an effective tool to attract business activity to the inner cities of America.

E. METHODOLOGY

A comprehensive review of existing literature and a search for the latest available information was conducted. Phone conversations and phone interviews made to a myriad of organizations that are familiar with either the President's program or the pending legislation, or are knowledgeable in urban economic development efforts encompass a majority of this research. These interviews gave a meaningful perspective on whether these initiatives will have a profound impact on stimulating economic development in distressed urban areas of America. These interviews also revealed alternative approaches

to successfully implement a Federally funded program that uses contracting incentives to promote economic activity in the inner city.

F. ORGANIZATION OF THE THESIS

This thesis contains seven chapters. Chapter I is comprised of a general introduction, objective, scope, methodology and organization of the thesis. It establishes the framework and guiding principles of the thesis.

Chapter II introduces the Empowerment Zone (EZ) Concept. It includes a brief overview of the concept to include the motive and purpose behind the EZ program. The chapter includes an historical background of this concept from its origination in the United Kingdom in 1977 as the enterprise zone program, to President Clinton's 1993 EZ program. The chapter also provides the most recent status on urban empowerment zones.

Chapter III introduces President Clinton's Executive Order 13005, the Empowerment Contracting Program. The chapter includes the purpose and intent of the executive order. It also outlines the order's major principles and provides definitions to clarify the mission. Furthermore, the chapter illustrates how the order's intent parallels with goals established in President Clinton's EZ program. Chapter III also introduces the HUBZone Act of 1997. It provides the purpose and intent of this bill along with describing the major components of the bill. The chapter illustrates the similarities and differences the bill offers in comparison to the Empowerment Contracting Program.

Chapter IV presents data and information gathered in a survey that the researcher conducted with participants familiar with either initiative discussed in Chapter III and issues surrounding urban economic development.

Chapter V analyzes the conclusions the researcher has made based on the information and data gathered from the phone interviews. Strategies for promoting economic development in the inner city with Federal contracting incentives are also suggested.

Chapter VI summarizes the thesis and offers answers to the primary and subsidiary questions listed in Chapter I. Specific recommendations for areas of further research are presented.

II. THE EVOLUTION OF THE EMPOWERMENT ZONE CONCEPT

A. OVERVIEW

The Clinton Empowerment Zone (EZ) program emerges from a history that has been filled with promise and disappointment. Promise, because EZ programs attempt to attack one of the root causes of urban poverty, the lack of jobs in the inner city. Disappointment, because, despite having been tried for decades, past EZs have failed to demonstrate convincingly their effectiveness. [Ref. 2:p. 1] The designers of the Clinton EZ program believe they have learned from past mistakes and that their version of EZ contains features which will make it more successful than its predecessors.

B. HISTORICAL BACKGROUND

The history of EZs demonstrates how their current form both resembles and differs from past versions. The basic policy of providing incentives to businesses to encourage them to locate in economically depressed areas has existed for many years. The political climate in which these policies were first implemented, however, led their designers to focus almost exclusively on the use of tax incentives. The Clinton Administration's addition of non-tax incentives represents a distinct departure from past EZs.

1. British Origins

The enterprise zone approach, as conceptualized and used in England, illustrated a strategy that involved improvements to the physical landscape of the area. The term, "enterprise zone" was initially used in a speech by Sir Geoffrey Howe in 1978 to describe a new policy for dealing with small areas in the most derelict and depressed sections of

British cities. [Ref. 1:p. 198] The concept required the creation of geographic zones within the inner city approximately one square mile in size that would be free of normal government regulatory policies and import duties. [Ref. 3:p. 15] The areas were typically old industrial areas, often near ports, which became vacant and rundown as economic forces reduced the demand for the warehouses or other businesses that once formed the economic basis for the area.

Rather than the public sector playing a proactive role as in previous urban programs, tax incentives and reduced regulation were intended to encourage the development of new enterprises, thus stimulating private investment that would create new jobs within the zone. Deep tax breaks were required, it was believed, to induce large corporations to invest in the zone. Attracting the investment of large corporations was deemed essential, because only they would have the resources and incentive to redevelop the entire area. [Ref. 1:p. 198] The British program was based on the notion that vacant sites make the best enterprise zones, with the zones acting as the focal point for the economic improvement of wide areas. [Ref. 4:p. 885]

Policymakers argued that the blighted industrial areas remained blighted because of governmental obstacles to large business. The preferred policy tool was to eliminate taxes and regulatory burdens in the blighted areas in order to stimulate private market activity. Most of the zones housed few residents; indeed, residential areas were often explicitly excluded from the zones. A zone program, it was hoped, would produce a small urban industrial park that would yield economic benefits to the larger geographic area. [Ref. 1:p. 198]

Advocates of the enterprise zone concept claim that by allowing market forces greater play, individuals and businesses pursuing a strategy of self-interest can accomplish what government could not. Enterprise Zones are intended to become generators of economic activity, rather than just redistributers of that activity. [Ref. 5:p. 432]

In 1981, two years following the election of the Thatcher government, Sir Geoffrey Howe, who was Chancellor of the Exchequer, announced the designation of 11 areas as enterprise zones. The zones' boundaries were eventually drawn so as generally to exclude businesses (in order to avoid the criticism of unfair competition) and residential areas. [Ref. 6:p. 5] Significant public sector involvement, such as direct land ownership or nationalized corporate ownership of either property or buildings, was also a common characteristic of the U.K. enterprise zones. [Ref. 6:p. 6]

The goal of the British program was to see how far industrial and commercial activity could be encouraged by the removal of certain tax burdens, and by relaxing or speeding up the application of certain statutory or administrative controls. [Ref. 7:p. 296] Peter Hall claimed that a major objective of the enterprise zones was to bring back derelict land and buildings into productive use by generating new industrial activity. [Ref. 5:p. 433]

The British enterprise zone program offered firms three tax incentives: an exemption from the property tax, full expensing of capital expenditures on industrial and commercial buildings, and exemption from the development land tax. [Ref. 1:p. 203] The program also reduced the burden of regulatory controls in various ways, such as by streamlining procedures and by relaxing certain reporting and planning requirements.

These incentives were designed to generate economic activity in the zone and create jobs. According to Rubin and Richards, the goal was clearly to generate new activity, not simply to redistribute activity or jobs from one part of the region to another. [Ref. 5 :p. 433]

2. The United States Experience

In 1980, Stuart Butler of the Heritage Foundation in 1980 introduced the concept of enterprise zones. [Ref. 2:p. 6] He argued that the British idea should be imported and thought it would be particularly successful given the American tradition of entrepreneurism. [Ref. 8:p.27] By 1981, Butler's idea attracted the curiosity of New York Congressmen Jack Kemp. The idea appealed to both men, for, as Butler writes, "to these politicians, the proposal was, in effect, a supply-side program to save the inner cities. It was the urban complement to the general conservative strategy of cutting taxes and regulation to stimulate economic growth." [Ref. 8:p. 5]

> The philosophy underlying the enterprise zone concept in England called for lower regulatory barriers and reduced taxes. The original idea in the United States was to promote local development in distressed areas primarily by reducing regulatory barriers. However, opposition from unions and environmentalists quickly shifted the emphasis to tax reduction. [Ref. 1:p. 198]

Because none of the Federal legislation was adopted in that year, the states began their own enterprise zone initiatives. [Ref. 5:p. 434] When George Bush became president, he introduced Enterprise Zones and appointed Jack Kemp as Secretary of the Department of Housing and Urban Development. Despite this pulpit, however, Kemp was still never able to get a bill passed. Each time it was introduced, it became lost in other political battles. [Ref. 9:p. 31]

Despite the lack of Federal action, a number of states implemented their own enterprise zone policies during the 1980s, in anticipation of the Federal legislation, which never came. By 1990, 37 states had set up zones. [Ref. 10:p. 2] The primary goals of all state enterprise zone programs were job generation and economic revitalization. There are five general types of incentives used with varying degrees of frequency among state programs. [Ref. 11:p. 4]

> These types, along with the percentage of state enterprise zone programs that us them, were tax incentives (94%), capital financing (43%), regulatory relief (46%), targeting of existing economic development programs (37%), and infrastructure/public service improvements (17%). The primary type of tax incentives and the percentage of state enterprise zone programs using these incentives are sales or use tax credits (51%), job creation and wage credits (51%), employer income tax credits (49%), selected hiring credits (43%), property tax credits (37%), and investment credits (29%). [Ref. 5:p. 433]

C. IMPACTS OF THE ENTERPRISE ZONE PROGRAM

1. United Kingdom

Roger Tym and Partners formulated the first empirical data concerning enterprise zone implementation and their impacts in Great Britain in a 1984 government-funded monitoring report. The "Year Three" report provides estimates and discussion concerning the amount of new economic activity that has been generated as a result of the designation of the original 11 British enterprise zones. [Ref. 5:p. 435]

According to the Tym report, the response to enterprise zone designation from the private sector in the United Kingdom had been positive but not overwhelmingly so, and had some negative locational effects. Developers looked favorably on zone locations, with a significant number of developers looking only in the enterprise zones for new

development sites within the respective metropolitan region. There was considerable evidence contained in the Tym report that land development activity within the zones was primarily a relocational effect within the metropolitan region. During the first three years of operation, 86 percent of firms relocating to the zones were from the same county as the enterprise zone. [Ref. 5:p. 435]

With regard to employment changes, the Tym report estimated that similar firms outside the enterprise zones grew in employment by 23 percent. The corresponding figure for firms within the enterprise zones was only 13 percent. Only about 25% of all new jobs within the 11 zones could be attributed to the enterprise zone designations, implying that only 4,000 jobs can be credited to the British enterprise zone program for its first three years of operation. [Ref. 5:p. 435] Interviews with businesses in the zones and with comparable establishments outside the zones also revealed that only 12 percent of new employees hired within the zones by existing companies could be credited to zone-created incentives.

> No difference was found between employment generation, investment activities, or production of companies in the zones versus companies outside the zones. The Tym report concluded that little new economic activity or new employment could be attributed to the enterprise zone program. [Ref. 5:p. 435]

In 1986, Schwarz and Volgy took a detailed look at Dudley enterprise zone and the overall costs and benefits of the British enterprise zone program. [Ref. 12:p. 104] A new firm locating in the Dudley zone was granted a complete tax write-off for new construction, no local property taxes, and virtually automatic permission for new projects. Between 1981 and 1986, significant employment grew, new companies entered the zone, and construction of industrial space was evident. But with deeper analysis, Schwarz and

Volgy found that the main effect of the zone had been locational. None of the new businesses they visited had begun operation because of the zone, but would have located elsewhere in the region in the absence of zone incentives. [Ref. 5:p. 437]

Schwarz and Volgy estimated the cost of job creation for the public sector between 1981 and 1986 for the original eleven zones was 180 million pounds. Using the figure of 25 percent of new jobs attributable to the U.K. enterprise zone program obtained from the Tym report, they found that the cost per new job was approximately 45,000 pounds or $67,000. [Ref. 5:p. 437]

More recent studies reinforce the criticism of the English enterprise zone program, confirming that most of the new economic activity in the zones simply relocated from nearby counties. In addition, several studies emphasize that, contrary to the original zone philosophy, the government invested large amounts of money to build infrastructure and buy land. [Ref. 1:p. 203] Hence most of the positive impacts of zone designation probably have more to do with public spending than with incentives. The only incentive that appeared to have an impact was the property tax. It proved most attractive to the larger firms, particularly those with higher capital-to-labor ratios and smaller job-generation potential per dollar of new investment. [Ref. 1:p. 203]

2. The United States

Empirical research on zone programs is limited. The modest amount of empirical research is due to two basic constraints: (1) the lack of reliable quantitative data to evaluate zone performance, and (2) the difficulty of isolating the effects of zone designation and incentives from those of other economic development factors and initiatives. [Ref. 17:p. 479] Nevertheless, a small body of empirical research is available.

Studies on an enterprise zone's economic effects have indicated that the concept has not lived up to its supporters' expectations. More specifically, the studies determined that tax incentives used by enterprise zones were relatively ineffective.

The U.S. Department of Housing and Urban Development (HUD) carried out one of the most comprehensive studies of enterprise zone impacts in 1986. HUD assessed ten enterprise zone programs in nine states, using data derived from a series of interviews with approximately 200 state and local officials, as well as with business and neighborhood representatives. The survey results showed that 263 zone firms were responsible for over $147 million in new investment, and 7,348 new or retained jobs. [Ref. 17:p. 479]

The types of zone firms varied in their capacity to generate jobs. New business start-ups accounted for approximately 33 percent of new jobs, and existing firms for 27 percent. Only a small proportion (14 percent) of new jobs was generated by relocating firms. [Ref. 17:p. 480] New branch expansions of outside firms created another 12 percent of the employment growth.

More detailed analysis revealed that most of the new investment (64 percent) in enterprise zones was made by either new business startups or the expansion of existing zone firms. [Ref. 17:p. 480] New branch operations generated 20 percent of investment growth, and relocating firms 11 percent. Of the new investment, most was made by small firms; approximately 63 percent of the firms making new investments in the zone had fewer than 50 employees. [Ref. 17:p. 480] Only four percent of investing firms had more than 200 workers.

The HUD study also assessed the perceptions and attitudes of program participants about the effects of zone designation and incentives.

> Respondents indicated that zone designation had encouraged significant business investment. Interestingly, the zone designation itself was found to be more important in inducing this investment than the tax incentives themselves were. Tax incentives did not play a major role in most firms' location decisions, although some firms were partly influenced by them. [Ref. 17:p. 480]

In 1990, the California Department of Urban planning conducted a survey to determine the impact of the California enterprise zone program on the locational decisions of new and expanding zone firms.

> The survey of 137 participating businesses revealed that only 24 percent viewed enterprise zone designation/incentives as a strong factor in their decisions about location. About 55 percent of the firms placed, "little or no importance", on zone designation or incentives in their location decisions. Location decisions were overwhelmingly influenced by the factors of real estate costs, site characteristics, road/rail access, and proximity of product market. [Ref. 19:p. 2]

Although tax incentives did not play a primary role in their location decisions, 40 percent of the survey respondents had used at least one of those available.

A more recent evaluation of the California zone program conducted in 1994 used County Business Patterns data on employment and establishments to estimate job generation and business development. The researchers found job growth across most of the zones and incentive areas. Between 1986 and 1990, employment had increased in all of the targeted areas except the Los Angeles-Watts incentive area. [Ref. 19:p. 4] In an effort to identify the underlying causes of the employment and business growth, the researchers conducted a shift-share analysis to isolate the effects of the zone/incentive

area program. Their findings illustrated that the zone/incentive area initiatives were not conclusively associated with any of the positive outcomes.

> Their findings suggest that five of the zone/incentive areas were at a significant competitive disadvantage compared to their surrounding county and regional areas. However, three of the targeted areas (San Jose, Los Angeles-Pacoima, and Sacramento-Northgate) seemed to have had a competitive advantage. The remaining targeted areas showed only modest zone effects. [Ref.19:p. 5]

The U.S. General Accounting Office conducted a quantitative assessment of the effects of three of the Maryland enterprise zones. The analyses revealed that both abrupt and gradual increases in employment had occurred after the enterprise zones took place. [Ref. 17:p. 483] Interviews with relevant employees within the zone, however, suggested that the enterprise zone program did not necessarily account for the changes. Rather, a fairly complex relationship between program incentives and business decisions was apparent. In general, firm representatives said the tax incentives played little or no role in their locational decisions, which were far more affected by market conditions, site characteristics, and general community attributes. [Ref. 20:p. 8]

An assessment of the New Jersey Urban Enterprise Zone program concluded that the program had indeed improved the "relative economic position" of the state's most distressed cities. [Ref. 21:p 1] A survey of 976 firms in the state's ten enterprise zones indicated significant growth in jobs and investment. The study also examined the influence of program incentives on the behavior of zone firms. For 32 percent of the firms, zone incentives were cited as a primary reason for location or expansion decisions; they were a secondary factor for 38 percent. However, the remaining firms (30 percent) were not influenced by zone incentives. [Ref. 21:p. 7]

In an effort to explain the variability in zone program outcomes, Sheldon and Elling studied the economic attributes and effects of 47 enterprise zones in Illinois, Indiana, Kentucky, and Ohio. [Ref. 22:p 1] The study examined the nature of zone firms that had received incentives.

> In each state, the majority of participating firms (57-70 percent) were existing businesses that had expanded. Many of the remainder (22-31 percent) were new start up firms. The proportion of participating firms that had relocated to take advantage of incentives ranged from 19 percent in Kentucky to a modest 6 percent in Ohio. [Ref. 17:p. 484]

Wilder and Rubin's Indiana Study undertook a detailed case study of the Evansville, Indiana, enterprise zone. Using firm level survey data, they found that from 1983 to 1986, 47 new businesses had been created in the zone, and 14 existing businesses had expanded. [Ref. 23:p. 1]

> Wilder and Rubin concluded the relative success of the Evansville zone was due to the economic viability of the zone area, a high concentration of industrial land use, autonomy of the zone's administration from local government, the credibility and competency of the zone manager, and the community organization role played by the zone association. [Ref. 17:p 484]

One of the most interesting findings was that there was no direct relationship between tax benefits to an employment sector and the extent of the employment growth in that sector. In fact, they observed that the majority of tax credits went to Evansville firms that created no new employment. [Ref. 23:p 8]

Studies of program costs are rare to find since most state enterprise zone programs do not require detailed reports of annual program costs. [Ref. 17:p. 17] Information on the amount of state revenue forgone through firms benefiting from zone incentives is usually unavailable because of the confidential nature of corporate tax

returns. Therefore, only a few studies have attempted to assess the costs of zone programs.

One such study was a more rigorous examination of one of the most successful programs, an Indiana EZ program established in six cities in 1984, which again found that the Zones significantly affected the rate of investment and job creation. [Ref. 13:p. 7] However, such gains did not come without a significant price. Although the overall annual cost per job was $4,564, the cost for each job created for a Zone resident, the true target of the EZ program, was $31,112. This compares unfavorably with other economic development programs in the United States. [Ref. 2:p. 10] Other program costs, in 1990 dollars, range from $10,752 for the JOBS program in the 1960s and 1970s, to $13,000 for the Business Loan program of the Economic Development Administration, to as high as $60,000 for the Public Works program of the Economic Development Administration. [Ref. 13:p. 9]

D. CONCLUSIONS OF THE ENTERPRISE ZONE PROGRAMS

1. The United Kingdom

While researchers reached differing conclusions as to the measurements of zone success, there is agreement across studies that the British zone program has failed in its goal of generating *new* industrial activity. [Ref. 25:p. 47] The increases in jobs that do appear within the British zones are clearly with either preexisting site characteristics of the zones (such as available land or market access) or transfer effects resulting from existing firms moving outside the zone to a location inside the zone. [Ref. 5:p. 440] The British Government's implementation of the enterprise zone concept primarily targeted areas of vacant land or unoccupied structures, rather than significant amounts of existing

industrial and commercial activity. This implementation did not establish a task force to manage the enterprise zone program. Relocation of existing firms appeared to be the dominant result of the British program, with this relocation coming at the expense of extensive public-sector investment in the infrastructure of each zone.

Citing the uniformity of evidence indicating that relocations were the source of activity in the zones, the British government decided to phase out the EZ program. The tax incentives for the initial zones expired in 1991, and the last two zones designated will expire in 1999.

2. The United States

It became clearly evident to state and local politicians that the enterprise zone program did not demonstrate the stronger performance that supporters had hoped. Studies of the state enterprise zone programs in the United States have revealed that some zones do succeed in meeting the goals of enhancing economic activity and generating new jobs. Although their results may be inconsistent, the studies do bring to light the overall effectiveness of the state enterprise zones. The following common factors emerged from the majority of the studies:

- Zone designation *may* encourage modest increases in private business investment within a zone,
- Zone incentives and regulatory relief play only a marginal role, if any, in the locational decision of firms,
- Relocational effects are present, but relocations account for less that 30% of new firms and 15% of new jobs in the zones, and
- The impacts of enterprise zones on job creation are mixed, with some zones appearing to have modest impacts on employment whereas other zones seem ineffective in this regard. [Ref. 5:p. 438]

Much of the debate over enterprise zones focuses on their assumed power to attract new investment with development incentives. The picture that emerges from

enterprise zone studies suggests that the relationship between incentives and development is complex. Some researchers argue the complexity in assessing the effectiveness of incentives is because the results reflect a more indirect effect of enterprise zones:

> That is, that the business community takes the mere existence of the zone program as a signal that the city and state have made a commitment to the zone area. That perceived commitment has a positive influence on decisions about investment and location. In such instances, enterprise zones have a kind of policy "placebo" effect. Hence, state and local decision-makers may support enterprise zones as economic development policy because the zones are a useful public relations and marketing device. [Ref. 24:p. 340]

One finding common to both the U.S. and U.K. programs is that enterprise zone incentives do not appear to be crucial decision factors for firms deciding whether or not to locate in the zones. [Ref. 5:p. 441] In the United States, it appears that enterprise zone incentives, if relevant at all, have impact only on the margin when all other locational factors for a firm are equally balanced between competing sites.

The results of state Zones are thus mixed. Though their overall effect is positive, they appear to be expensive, and their impact has been difficult to measure. This mixed picture of zone effects points to their limitations. Enterprise zones cannot overcome all physical, social, and economic barriers to revitalization.

> In this respect, zone critics are correct in arguing that the myriad of social and physical problems plaguing many neighborhoods (e.g. decaying infrastructure, high crime rates, inadequate school systems) are not responsive to targeted development incentives. [Ref. 17:p. 487]

E. PRESIDENT CLINTON'S EMPOWERMENT ZONE CONCEPT

With the election of Bill Clinton to the U.S. presidency in 1992, the Empowerment Zone (EZ) concept returned as a national agenda. The EZ Initiative

became the key element in President Clinton's community revitalization strategy. This Initiative became the first step in rebuilding communities in America's poverty –stricken inner cities and rural heartland. It is designed to empower people and communities across the United States by inspiring Americans to work together to create jobs and opportunities. [Ref. 14:p. 5]

However, the evidence from the past EZs and President Clinton's own political philosophy convinced him that tax incentives were not enough to have a significant impact on business decisions [Ref. 15:p. 54] The Clinton Administration appears to have learned from the lessons of the state experience with development incentives and consequently, has included more community building components in its new Federal EZ program.

Furthermore, from a planning perspective, not one of the studies of state enterprise zones discussed found that a planning process was characteristic of the evolution of enterprise zones. This issue has, in fact, been addressed for Federal enterprise communities and empowerment zones. The Clinton Administration requires all applicants engage in strategic planning to decide how the goals of the Federal legislation would be addressed. [Ref. 17:p. 20]

Signed into law on August 10, 1993, the legislation authorized the Secretaries of HUD and Agriculture to designate communities to receive significant tax incentives and block grants for job creation and community development. [Ref. 14:p. 6] Nine zones, all located in urban areas, were selected in December 1994. This 10-year program targets Federal grants to distressed urban and rural communities for social services and community redevelopment and provides tax and regulatory relief to attract or retain

businesses in distressed communities. [Ref. 16:p. 1] For the ten-year life of the program, the Clinton plan granted urban EZs a $100 million community block grant to be used however local administrators see fit. This was in addition to an estimated $150 million that would still be provided in the form of tax incentives. [Ref. 2:p. 7]

F. STATUS OF URBAN EMPOWERMENT ZONES

In December, 1996, the Government Accounting Office (GAO) published a report that cited the status of urban EZs. The study surveyed six urban EZs to determine if the revitalization effort launched by President Clinton in 1993 was indeed working. GAO conducted a survey with program participants at the Federal, state, and local levels.

> Over half of the 27 program officials who responded agreed that community representation on the EZ governance boards, technical assistance provided by HUD's contractors, enhanced communication among stakeholders, and support from the city's mayor and from White House and cabinet-level officials had helped the program's implementation. Conversely, the difficulty in selecting a governance structure, the additional layer of bureaucracy created by the state government's involvement, preexisting relationships among EZ stakeholders, pressure for quick results, and the lack of federal funding for the program's initial administrative activities were frequently identified as factors constraining implementation. [Ref. 16:p. 2]

Congress and HUD made evaluation plans an integral part of the empowerment zone program through legislation and guidelines. HUD required each EZ to prepare a strategic plan indicating how it would satisfy the EZ program's four key principles: creating economic opportunity, creating sustainable community development, building broad participation among community-based partners, and describing a strategic vision for change in the community. HUD also required the strategic plan to include realistic performance benchmarks for measuring progress in implementing the program.

> All six of the urban EZs prepared strategic plans that include benchmarks describing the activities that the EZ planned to accomplish during the first two years of the program. These efforts constitute the initial steps towards establishing results-oriented measures for the EZ program. However, HUD and the EZs have yet (1) described measurable outcomes for the program's key principles or (2) indicated how the outputs anticipated from one or more benchmarks will help to achieve those outcomes. [Ref. 16:p. 3]

Unless they can measure the EZs' progress in producing desired outcomes, HUD and the EZs may have difficulty identifying activities that should be duplicated at other locations.

G. SUMMARY

The emergence of enterprise zones as tools to promote new economic activity in distressed areas has been proven mildly successful in both the British and American experience. The British national program was intended to promote new economic activity in vacant areas with little or no industry and few resident. Enterprise zones programs at the state level, by contrast, had an explicit community revitalization focus and areas with relatively high unemployment and poverty rates were targeted. [Ref. 25:p. 38] Both programs used incentive packages which provided deep tax breaks to investors who were willing to conduct business in the targeted areas. For reasons mentioned in this chapter, studies of both the British and American programs displayed a lack of effectiveness in generating significant economic activity in the targeted areas. More specifically, in both cases, tax incentive played in a small, if negligible, role in attracting businesses to the targeted areas.

The Clinton Administration's EZ program has learned from the mistakes of the British and state enterprise zone experiences and has formulated a Federal program to revitalize America's poverty-stricken inner cities and rural heartland. This new

revitalization effort will use tax and non-tax incentives to attract businesses to targeted EZs as well active community participation in the program's implementation and strategic planning to ensure the program's success.

The following chapter focuses on the efforts to apply Federal contracting incentives to attract businesses to areas of economic distress in the United States. This non-tax incentive has never been exercised at the Federal level. However, in the past two years, there has been legislation formulated to make this issue a national agenda.

III. PROMOTING ECONOMIC DEVELOPMENT WITH FEDERAL CONTRACTING INCENTIVES

A. OVERVIEW

The idea of applying Federal contracting incentives as a means of promoting economic activity in distressed urban and rural areas has surfaced as another method to cure urban and rural economic ills. This non-tax incentive has been considered by policy makers as having the potential for being the most effective tool the Federal Government can use in its efforts to revitalize America's inner cities and rural heart lands. Over the past two years, two initiatives have been proposed which would employ Federal contracting incentives in order to promote economic activity in America's distressed areas.

In May 1996, President Clinton issued Executive Order 13005, the Empowerment Contracting Program. This order was an extension of his administration's 1993 Empowerment Zone (EZ) /Enterprise Community concept. As of this May, the Department of Defense, the General Services Administration, and the National Aeronautics and Space Administration have proposed amendments to the Federal Acquisition Regulation (FAR) to establish an Empowerment Contracting Program that would provide procurement incentives to both large and small businesses to encourage their activity in areas of general and severe economic distress.

This past January, Senator Christopher Bond, (R, MO) the Chairman of the committee on small business, proposed the Historically Underutilized Business Zone (HUBZone) Bill of 1997. This initiative would provide any small business, conducting

business activity in a HUBZone, contracting preference if bidding on a Federal contract. The bill is presently being marked up for statute.

This chapter describes the major components of Clinton's Executive Order and the HUBZone bill. Furthermore, the chapter illustrates that, although both initiatives have similar goals of promoting economic development in America's distressed inner cities and rural heartlands, they differ in the methods of achieving this underlying goal.

B. EXECUTIVE ORDER 13005

On May 21, 1996, President Clinton signed an executive order on Federal contracting call the Empowerment Contracting Program. This initiative provides a supplement, not a replacement, to existing Federal procurement programs.

> In the Order, the President charged the Secretary of Commerce, in consultation with the Secretaries of HUD, Labor and Defense; and the Administrators of the General Services Administration, NASA, the Small Business Administration to develop policies and procedures to ensure that Federal agencies, when awarding contracts in unrestricted competitions, grant qualified large and small businesses appropriate price or evaluation incentives to encourage business activity in areas of general economic distress. [Ref. 28.p. 27556]

Vice President Gore initiated the Order in his role as Chair of the Community Empowerment Board, the Cabinet-level group that coordinates the Administration's community empowerment zone initiatives.

> We recognize the private sector must be the driver of economic opportunity. However, as this order makes clear, the government can be an effective partner by helping distressed communities attract private-sector investment and providing these communities with the tools to solve their own problems. [Ref. 27:p. 2]

On September 13, 1996, the Department of Commerce (DOC) published, in the Federal Register, its proposed guidelines for implementing Executive Order (EO) 13005.

DOC then requested feedback from the public on these guidelines, which would be used to help draft the final guidelines and proposed amendments to the FAR. Comments were received from 40 commentaries. They included businesses of all sizes, not-for-profit entities, industry and trade associations, Federal Agencies, State and local governments, and one member of Congress. [Ref. 28:p. 27556] In May, 1997, the guidelines for the Order were revised and published in the Federal Register.

1. Definitions

(1) *Qualified eligible business* means a small or large for-profit or not-for-profit trade or business that meets one of the following criteria:

- Employs a significant number of residents from areas of general economic distress
- Has a significant physical presence in areas of general economic distress
- Has a direct impact on generating significant economic activity in areas of general economic distress

(2) *Area of general economic distress* means, for all urban and rural communities, any census tract that has a poverty rate of at least 20 percent or any designated Federal Empowerment Zone or Enterprise Community. [Ref. 28:p. 27558] This definition also applies to a rural area or Indian reservation that currently meets the criteria for designation as a redevelopment area.

(3) The following definitions apply to businesses seeking pre-qualification and self-certification based on current operations:

> *Employs a significant number of residents from the area.* This means a business which, during the six months preceding the date of its request for qualification, has expended **as least 25 percent** of its total labor costs in

wages and benefits to residents from areas of general economic distress. [Ref. 28:p. 27559]

Has a significant physical presence in the area. This means a business with physical plant (s) in areas of general economic distress where, for the six months preceding the date of its request, **at least 25 percent** of the employee of the business perform their job. Employees will be considered to perform their job at the location where they spend the most time working, so long as it is at least 6 hours per workweek. [Ref. 28:p. 27559]

Has a direct impact on generating significant economic activity in the area. This means a business which:

(i) During the six months preceding the date of its request for qualification, has expended **at least 50 percent** of its total labor costs in wages and benefits to residents from areas of general economic distress; or

(ii) During the six months prior to submitting its request for qualification, has incurred **at least 25 percent** of its expenses on goods, materials, and services from firms located in areas of general economic distress. [Ref. 28:p 27559]

2. Self-Certification of Eligibility

At the time the business self-certifies its eligibility, the business will be expected to have prepared a short description of its plan for achieving the requirements of this program. The plan description to be kept in Commerce's file on that business, should contain sufficient detail to enable DOC to reach an informed judgement of the likelihood of the plan's success.

The description should identify the areas of general economic distress where employees will be recruited, the types of positions they will occupy, and evidence that those types of employees are available in sufficient quantity from those areas;

The description should identify the areas of general economic distress where the physical plant (s) likely will be located, the types of plant that are required, evidence that such plant (s) are available, and the types and numbers of individuals who will be employed there;

> The description should identify the types of goods and services that likely would be purchased, and likely sources of those goods and services located in areas of general economic distress. [Ref. 28:p. 27559]

DOC will conduct random reviews of the self-certifications submitted by businesses to verify their eligibility. If there is reason to believe that a business has submitted false information, or otherwise violated federal law, the matter will be promptly referred to the Department's Inspection General for investigation. [Ref. 28:p 27559]

3. Pre-Qualification for Eligibility

Upon request, DOC will issue certificates that businesses have met the pre-qualification requirements as stated in the eligibility requirements of the Order. If there is reason to believe that a business has submitted false information, withheld relevant information, or otherwise violated federal law, the matter will be promptly referred to the Department's Inspector General for investigations.

4. Incentive Structure

Incentives, in the form of price or non-price evaluation preferences, shall be available in contracts subject to the guidelines established in EO 13005. A price evaluation preference of ten percent shall be granted to qualified businesses in acquisitions where price or cost is a significant evaluation factor. The Contracting Officer will apply the preference on a line item basis or apply it to any group of items on which award may be made. The Contracting Officer shall add other evaluation factors such as transportation costs or rent free use of Government facilities to the offers before applying the price evaluation preference. [Ref. 42:p. 19202]

A non-price evaluation factor shall be used in acquisitions when price or cost is not a significant evaluation factor. The Contracting Officer shall ensure that the factor will be given sufficient weight to be meaningful when source selection is made on a best value basis. When the non-price evaluation factor is used, and the source selection uses a numerical rating system, the non-price evaluation factor for empowerment contracting may be given a weight of up to 15 percent. [Ref. 42:p. 19203] Preferences in the form of incentives shall represent a price preference of up to ten percent or an evaluation credit of up to 15 percent. The Contracting Officer/Source Selection Official shall have the discretion to determine the size and type of incentive to apply to any particular procurement. [Ref. 28:p. 27561. The clear intent of the Order is for the Empowerment Contracting incentive to be used in addition to the other incentives and preference programs that are provided by the procurement process. [Ref. 30:p. 1]

5. Monitoring and Evaluation

(1) *Monitoring the Federal Procurement Process.* To assist in monitoring and evaluating the efficiency of this program, agencies awarding contracts to qualified businesses shall provide the following information to the DOC:

(i) The number and dollar amount of solicitations in which an empowerment zone contracting preference was offered. This information will be broken down by SIC Major Group Codes and by the use of the price evaluation preference and non-price evaluation factor.

(ii) The contract numbers, dollar amounts, names of awardees, and price premiums paid (if identifiable) for awards made as a result of an empowerment preference. This information is broken down by SIC Codes. These codes are used by the Federal contracting system to define industry by the type of activity that a business is engaged in. [Ref. 26:p. 3]

(iii) Comments on the advantages and disadvantages of the Empowerment Contracting Program, including comments

on whether the program had an impact on the quality of supplies and services procured through its use. [Ref. 28:p. 27561]

(2) *Monitoring the impact on business development.* A sample of businesses receiving contracts under the program would be examined with the following issues being addresses:

(i) Did the business locate or remain in a particular place so that it would be eligible for preferences under these guidelines?
(ii) Did the business hire new workers or provide additional benefits to existing workers from eligible areas so that it would be eligible for preferences under these guidelines?
(iii) Did the business purchase additional goods and services from firms located in eligible areas so that it would be eligible for preferences under these guidelines?
(iv) Did the business propose to hire more workers in eligible areas as a result of bidding or proposing under the subject contract?
(v) Is this contract new work that the business would not have received but for this program? [Ref. 28:p. 27561]

6. Phased Implementation of the Program

The program has a phase-in process. As the program proceeds, the DOC wants to make sure the program is achieving the objectives of the Executive Order. The phase-in process allows the DOC to properly monitor and evaluate the program's effectiveness. In response to comments received on the Order's guidelines from businesses of all sizes, not-for-profit entities, industry and trade associations, Federal agencies, and State and local governments, the length of the first phase of the program was extended from its original six-month period to 18 months. This longer period for phase one will allow for accumulation of a larger base of data regarding the effectiveness of the Program. Eleven two digit SIC Code major group identifiers have been selected for inclusion in phase one. [Ref. 28:p. 27562] The SIC Codes define industry by the type of activity that a business

is engaged in. Review of phase one by the DOC will begin after 12 months. The goal of the first phase is to see if the Program is most effective luring current government contractors to distressed areas, luring businesses in growth industries to distressed areas, or encouraging sales for businesses located in distresses areas.

Further implementation of the Order will be instituted in the second phase of the program, which will begin after the first phase of the program has ended, and will extend for a period of five years. [Ref. 28:p. 27562] The second phase will be applied to a larger number of contracts within selected two digit SIC Code industries involved in competitive Federal procurements. At the end of this five-year period, the DOC in consultation with the agencies designated by the Executive Order will ascertain whether the program is meeting its goals. [Ref. 28:p. 27562] More specifically, it will determine whether the program stimulated economic activity via job creation or new business investment in areas of general economic distress and benefited the federal procurement system.

C. HISTORICALLY UNDERUTILIZED BUSINESS ZONE ACT (HUBZone) OF 1997 (S. 208).

On January 28, 1997, Senator Christopher Bond, chairman of the Senate Small Business Committee, proposed legislation intended to make small business located in economically distressed urban and rural areas eligible for Government contract set-asides and preferences in receiving Government contracts. The bill is intended to create new opportunities for small business in urban and rural communities that have suffered economic decline while creating job opportunities for hundreds of thousands of unemployed. [Ref. 35:p 235]

Under this proposed bill, small business opportunities would be created by non-race or non-gender based preference. That is, to be eligible, a small business would have to be:

> (1) Owned and controlled by one or more U.S. citizens; (2) located in a HUBZone; and (3) a minimum of 35% of its work force would have to reside in the HUBZone. The small business would have to certify to the Small Business Administration (SBA) that it is located in a HUBZone, that it will comply with certain federal subcontracting rules, and perform at least 50% of a contract in a HUBZone unless terms of the contract require the performance be elsewhere. The SBA would have full authority over the HUBZone program, including its administration and enforcement. [Ref. 30:p. 2]

The intent of this legislation is to provide an immediate infusion of cash in America's economically distressed areas through the creation of new jobs. During his eight years as Governor of Missouri, Senator Bond frequently met with community leaders who were seeking help in attracting businesses and jobs to their cities, their central downtown areas, their homes, and the rural areas of the State. [Ref. 39:p. 2] Senator Bond promoted various programs, including the enterprise zone concept and has witnessed minimal success. Now as a U.S. Senator and chairman of the Committee on Small Business, he continues to receive similar pleas from people in Missouri as well as throughout the Union.

The HUBZone Act of 1997 is specifically designed to avoid bureaucratic roadblocks that have delayed and discouraged small business from taking advantage of Government programs. These roadblocks are evidenced in SBA's 8(a) Minority Small Business Program and the sometimes-cumbersome rules for small businesses seeking to qualify for the program.

> Typically, an applicant to the 8(a) program has to hire a lawyer to help prepare the application and shepherd it through SBA. The procedure can take months. In fact, Congress was forced to legislate the maximum time the agency could review an application in our last-ditch effort to speed up the process. [Ref. 30:p. 2]

Simply put, if a company is a small business located in a HUBZone and hires at least 35 percent of their employees from the HUBZone, then the company is eligible. Once eligible, the small business notifies the SBA of its participation in the HUBZone Program and is qualified to receive Federal Contracting benefits. The SBA Administrator or his designee shall establish a system to verify certifications relating to disposition of any challenges to the accuracy of any certification. [Ref. 39:p. 2]

Senator Bond has outlined the percentage of Federal Government contracts that he feels should be earmarked for HUBZones.

> In 1998, one percent of all Prime Government Contracts would be awarded to small businesses in HUBZones. The goal would increase to two percent in 1999, three percent in 2000 and four percent in the year 2001 and each year thereafter. [Ref. 31:p. 3]

This is a welfare-to-work bill to create jobs for those most in need and to stimulate investment in communities that need the most help. Inner cities, rural counties, Indian Reservations, wherever there is a high unemployment rate and poverty, there is a HUBZone. Senator Bond argues that if there is a geographic concentration of HUBZone Businesses receiving Government contracts, there will also be a concentration of jobs and investment in areas neglected for years and even generations. [Ref. 39:p. 3] The Senator reiterates his belief that there is no other program in Government that is capable of producing such hope.

1. Definitions:

Historically Underutilized Business Zone (HUBZone): Any area located within a qualified metropolitan statistical area or qualified non-metropolitan area.
Small business concern located in a HUBZone: A small business whose principle office is located in a HUBZone and whose workforce includes at least 35% of its employees from one or more HUBZones.
Qualified Metropolitan Statistical Area: An area where not less than 50% of the households have an income less than 60% of the metropolitan median gross income as determined by the Department of Housing and Urban Development.
Qualified Non-metropolitan Area: An area where the household income is less than 80% of the non-metropolitan area median gross income as determined by the Bureau of the Census of the Department of Commerce.
Qualified Small Business Concern: Must certify in writing to the SBA that it is located in a HUBZone, will comply with subcontracting rules in the FAR, and will insure that not less than 50% of the contract cost will be performed by the Qualified Small Business. [Ref. 31:pp. 1-2]

2. Contracting Preferences:

- The Small Business Act is amended to give qualified small business concerns located in HUBZones a *higher preference* than other small business concerns owned and controlled by socially and economically disadvantaged individuals.
- A Contract Set-Aside to a qualified small business located in a HUBZone can be made by a procuring agency, if it determines that two or more qualified small businesses will submit offers to the contract, and the award can be made at fair market price.
- Sole source contracts may be awarded if a qualified small business submits a reasonable and responsive offer and is determined by the SBA to be a responsible contractor. Sole-source contracts cannot exceed five million dollars.
- In any case in which a contract is to be awarded by the head of an executive agency on the basis of full and open competition, the price offered by a qualified small business concern located in a historically underutilized business zone shall be deemed as being lower than the price offered by another offeror (other than another qualified small business concern located in a historically underutilized business zone) if the price offered by the qualified small business concern located in a historically underutilized business zone is not more than 10 percent higher than the price offered by the other offeror. [Ref. 31:pp.2-3]

D. ISSUES CONCERNING THE HUBZONE BILL OF 1997

There have been numerous hearings held by the Senate Committee on Small Business as well as significant commentaries issued by federal agencies, private businesses, and not-for-profit organizations on the HUBZone bill. Overall, there has been generally positive support for the bill. However, there have been criticisms as well as recommendations made by commentaries on how to improve it.

1. Commentaries

The limitation that benefits will only go to small business has been endorsed and criticized. For instance, Sandra Newman, CEO of Raritan Container Company in New Brunswick , New Jersey, claims that most new jobs are created by the growth of small business.

> If there were government contract set-asides for "inner-city, small companies" these companies, like mine, would add workers from the local community to fill the jobs created by the additional business these contracts would create. This would benefit these small companies whom when they grow, reinvest in the inner city, like we did. These contracts would have the immediate effect of creating opportunity for small inner city companies and perhaps be an inspiration to other companies to consider inner-city locations. [Ref. 32:p. 2]

However, it has been recommended by others to include large businesses. For instance, Fabio Sampoli, Senior Vice President of the Greater New Haven Chamber of Commerce, questions whether the program should be limited to small business.

> With the proper incentives in place, larger companies may have the capital and the wherewithal not only to make a greater impact by creating more jobs, but also to lead to beneficial quality of life spin-offs, such as the redevelopment of brownfields and the spurring of retail development. [Ref. 33:p. 2]

Although Mr. Sampoli is opposed to legislation that interferes with the workings of the free market economy, he welcomes the HUBZone legislation. By directing a meaningful amount of Federal contracts to businesses within HUBZones, the Act would definitely lead to the creation of jobs in inner city areas with high poverty and unemployment rates. [Ref. 35:p. 236]

The requirement that 35 percent of the workforce be employed from the HUBZone has received mixed reviews. Supporters of this requirement claim that this mandate in the HUBZone legislation will clearly illustrate if a HUBZone contractor is generating jobs in the HUBZone. Opponents argue that 35 percent is too high given the fact that it is already difficult to attract and recruit highly skilled laborers in the work place. Roger Mody, President and CEO of a technology firm, Signal Corp., clearly supports this reasoning.

> That's great, except when I have a government contract requirement that stipulates that I must have a person with a master's of science degree in electrical engineering with 10 years of experience, what is the ratio of qualified candidates I would be able to recruit within that HUBZone would be my question! [Ref. 34:p. D4]

The HUZone preference over 8(a) contractors has generated harsh criticism from Small Disadvantaged Business (SDB) and other minority contracting advocates. Anthony Robinson, President of the Minority Enterprise Legal Defense Education Fund, Inc., testified before the Senate Committee on Small Business on April 10, 1997. His statement concerning the HUBZone preference is as follows:

> We do not impugn the motives of those who support S. 208 or its derivatives. We simply do not believe that such objectives should be achieved at the expense of the existing 8(a) and SDB programs which are linchpins of federal efforts. While it is not explicitly stated, the ultimate

> effect of S. 208 is to repeal all programs benefiting small, disadvantaged businesses. [Ref. 36:p. 6]

Santos Garza, CEO of Counter Technology Inc., spoke on behalf of the Latin American Management Association (LAMA) at the April 10, 1997, hearing on the HUBZone bill. Mr. Garza strongly urged the Committee to reconsider giving preference to HUBZone contractors over 8(a) contractors as the Committee mark-up the bill.

> Some contracting opportunities may be better suited for the 8(a) program or a small business set-aside, while others may be more appropriate for a HUBZone set-aside. We suggest that contracting personnel along with small business specialists and procuring agency technical personnel should be given the discretion to determine which vehicle is most appropriate. I do not see any reason why we cannot have two set-aside contracting programs that run concurrently without one functioning at the expense of the participants in the other program. [Ref. 37:p. 5]

The Committee on Small Business defended its HUBZone legislation by firmly stating that placing the HUBZone program ahead of the 8(a) program would have little or no negative impact on the 8(a) program.

> Of about $200 billion in federal contracts in fiscal year 1996, the 8(a) program accounted for approximately $7 billion. The HUBZone bill calls for a 4 percent goal awards to eligible businesses after four years. Thus, there are "plenty of {contracting opportunities} out there." [Ref. 38:p. 369]

In his opening statement of the April 10, 1997, hearing on the HUBZone Act of 1997, Senator Bond emphasized that the bill would not kill the 8(a) program like so many 8(a) advocates believe. Incorrect charges have been made that the HUBZone Act calls for the phasing out of the 8(a) program and other minority business programs. [Ref. 38:p. 369] Nothing in the HUBZone Act of 1997 changes the goals or objectives of the 8(a) program.

2. Small Business Administration (SBA) Observations

On April 10, 1997, the SBA chief, Aida Alvarez testified before the Senate Small Business Committee on the HUBZone legislation and clearly indicated that this bill would have an adverse affect on the 8(a) program and would further strain SBA resources. The SBA chief proclaimed that the bill appears to give unfair advantages to HUBZone firms vis-à-vis 8(a) firms.

> The HUBZone bill would allow firms to qualify for sole source contracts and price preferences without the stringent certification and continuing eligibility requirements that are currently placed on 8(a) participants. Sole source awards under the HUBZone bill could also reach $5,000,000 in size, while most 8(a) firms are limited to awards that can not exceed $3,000,000. [Ref. 40:p. 4]

The HUBZone incentives are offered only to small businesses located in and employing residents of the distressed area. More than 6,000 areas could be declared distressed areas. [Ref. 39:p. 2] Aida Alvarez believes that the resources needed for proper program oversight could be substantial. Yet, there are no new resources for the costs of implementation proposed in the bill. SBA needs to have resources to ensure the law, if enacted, is implemented and enforced. [Ref. 40:p. 5] The Inspector General of the SBA summed up this issue by stating:

> In short, SBA lacks the employee base to manage this program to a successful conclusion, and the Office of Inspector General (OIG) could not be counted on to provide sufficient, independent oversight of SBA's efforts given its current resource constraints. The truth of the matter is that the OIG is not now providing adequate oversight of SBA's current program mix and supporting operations. [Ref. 41:p. 5]

The SBA stressed its beliefs that much can be done under current law to achieve the objectives the Senate Committee on Small Business seeks. Aida Alvarez was

referring to the Executive Order 13005, the Empowerment Contracting Program. Like S. 208, the Administration's Empowerment Contracting Program is designed to strengthen the nation's economy by promoting economic opportunity and business growth in distressed urban and rural communities. [Ref. 40:p. 2] Through its employment features and geographic targeting, it also complements the Clinton Administration's other community empowerment initiatives that are currently at work in existing Empowerment Zone and Enterprise Communities throughout the country. The Empowerment Contracting Program ensures that agencies grant Federal contract incentives to firms, both small and large, to encourage greater business activity in areas of general economic distress.

The SBA cited another important feature of the Empowerment Contracting Program, its implementation through a phased approach. Segregating the program into two phases, will allow the Department of Commerce the monitoring and evaluating capability to determine what works and what does not work. The HUBZone legislation does not have a phased approach to implementation.

SBA also stressed to the Committee that the eligibility of self-certification by HUBZone candidates while laudable in its efforts to reduce certification costs and delays, invites inadvertent and deliberate abuses.

The SBA did not publicly endorse the HUBZone bill. The SBA chief stopped short of asking Senator Bond to abandon his bill but ended her testimony on the bill by stating:

> We believe that the Administration's Empowerment Contracting approach offers greater advantages in that it preserves administrative flexibility, builds on existing initiatives in Empowerment Zones and Enterprise

> Communities, does not overly disrupt the current procurement processes, and allows us to test the new approached through a phased approach. [Ref. 40:p. 6]

D. SUMMARY

Revised implementation guidelines for phase one of the Empowerment Contracting Program have been published in the Federal Register and have been amended to the FAR as of May 20, 1997. The HUBZone bill has been successfully marked up for statute by the Senate Committee on Small Business and is pending statute approval from Congress

The Empowerment Contracting Program and the HUZone Bill have the same goals of creating jobs and promoting economic activity in the inner city but approach implementation of these goals in different ways. Both initiatives contain attributes that the other could employ in its program to be effective in generating jobs and economic activity.

The following chapter describes the phone interview surveys the researcher conducted with organizations and individuals familiar with these issues. The chapter then discusses the findings the researcher made based upon the survey questions.

IV. SURVEY AND RESULTS

A. METHODOLOGY

To determine the most effective strategy to employ Federal contracting incentives to promote economic activity in America's inner cities, comments were sought from organizations familiar with this issue.

A series of in-depth interviews were held with participants that were either:

a) Familiar with either S. 208 or EO 13005 and;

b) *Knowledgeable in urban economic development issues.*

Interview questions centered on the topic of promoting economic development in America's inner cities with Federally funded contract incentives.

Over two months of phone interviews generated 32 participants in the survey. The participants came from six major areas of society. The designated area and percentage of the total number of participants surveyed are provided.

- Private sector firms: **(28%)**
- Community-Based Organization: **(25%)**
- Economists/University Professors: **(15.5%)**
- Federal agency organizations: **(12.5%)**
- City government organizations: **(12.5%)**
- Special interest groups: **(9.5%)**

For purposes of this study, the private sector is defined as large, medium-sized, and small businesses. Community-Based Organizations (CBOs) are defined as not-for-profit organizations that have intimate knowledge and influence within inner city

communities, and assist in creating conditions under which the private sector considers investing in the inner city. Federal agency organizations are organizations such as the SBA, NASA, and Senate and House Committees on Small Business. Economists/University Professors hailed from banks in Boston and Detroit as well as the following institutions of higher learning: Northeastern University, Michigan State University and Indiana University. City government organizations were comprised of economic development organizations from the Offices of the Mayor of Detroit and Chicago, Office of the Governor of Alaska, and the Greater New Haven Chamber of Commerce.

By questioning a myriad of participants with varied backgrounds, the researcher was attempting to find a commonly shared pattern of thought among these participants concerning issues surrounding legislation to promote economic activity in the inner city with Federal contracting incentives. Furthermore, from these phone-interview surveys, the researcher was hoping to discover new and informative economic development strategies that policy makers possibly used to enhance existing and proposed initiatives.

B. SURVEY QUESTIONS & RESULTS

The format for every phone interview conducted, centered around ten questions. These questions were deemed influential to this study based upon the research that was completed on the EZ concept, EO 13005, and the HUBZone bill. The following section contains the question, followed by the answers generated by the participants. An analysis of the participant's remarks concludes each question.

1. Will companies locate into the inner city solely on the basis of Federal contracting incentives? (Y/N)

Of the 32 participants in the survey, two (one firm and one CBO) participants believed this type of initiative would spur economic development in the inner city. The Remaining 30, did not believe this initiative could on its own merit achieve this goal. Barry Corona, President and CEO of Production Products Manufacturing & Sales, Inc., St. Louis commented that not only will some companies move into the inner city but the legislation should look at the existing businesses in the inner city to take advantage of these Federal contracting incentives. "There is no need for the Government to attempt to lure manufacturing companies into these urban areas because there are many small, minority manufacturing companies that already exist in these areas that can fulfill the contract requirements." [Ref. 43]

Glynn Loope , Executive Director of the Allegheny Highlands Economic Development Authority in Covington, Virginia, remarked that the financial incentive tied to a Federal contracting incentive program such as the HUBZone bill will have a huge impact on companies seeking to conduct inner city business with the Federal Government. "Large and small businesses would be attracted to a bill that will direct up to four percent of all government contracts be set aside for areas of general economic distress. That equates to roughly $7.2 billion. The financial incentive will spur entrepreneurship." [Ref. 44]

The remaining 30 participants remarked that the program would have minimal impact on promoting economic development in the inner city. The primary reason given was that the program would only be a single economic development tool which is only

part of the strategy in the Government's inner city revitalization effort. As Barry Rubin, Associate Dean of Indiana University remarked, "these initiatives must be a part of a whole strategy to revitalize the inner city. It must be connected with other efforts. [Ref. 45] These other efforts include Federal, state and local government initiatives to rebuild the infrastructure of the inner city to make it more attractive to companies. As Anne Habiby of the Initiative for Competitive Inner City remarked, "Federal, state and local government must build the infrastructure to make the inner city attractive to companies. Companies will move to the inner city if there is a competitive advantage for the company". [Ref. 46] David Triesch, Director of the Economic Development Practice of the Fuldin company recommended, "Have the feds invest not in contracting incentives but rebuilding infrastructure of inner cities to make it more attractive to businesses." [Ref. 47] Improving city infrastructure encompasses a wide array of objectives such as, improving roads and highways, developing public parks, restructuring buildings, cleaning up brownfields (environmentally contaminated land) and increasing the number of police in the inner city. David Triesch went further to state, "A person would have to be a complete idiot to a make a siting/locational decision for the company if in fact it wasn't in the overall interest of the company. Nobody {firms} relocates based solely on incentives!"[Ref. 47]

Tom Dalfo, the Project Manager of the Cooper's Ferry Development Association in Camden, New Jersey, believes private firms will not relocate their operations to inner cities based solely on contracting preferences.

> As I understand these programs, the level of preferential treatment is not substantial enough to underwrite the significant costs of relocation. Firms seeking to find new space for reasons independent of contracting

> preferences may find these programs attractive enough to locate into the inner city. However, the driving force for this location decision would be a business condition from these programs. [Ref. 48]

Other participants cited the lessons learned from the poor performance of state-sponsored enterprise zone programs that relocation decisions made by businesses based on artificial inducements such as tax or other incentives produced minimal impact in economic generating economic activity in the inner city. These participants believed that businesses that locate in an area because of tax breaks or other artificial inducements instead of genuine competitive advantages, generally prove not to be sustainable. "Research is accumulating from around the world that few businesses make location or hiring decisions based on such incentives—especially the modest ones commonly associated with these programs". [Ref. 49] Bob Tannewald, Senior Economist of the Federal Reserve Bank of Boston, declares, "Business location depends largely on factors outside of governmental control, such as climate, energy costs, proximity to markets, and the availability of appropriately skilled labor." [Ref. 50]

Survey data on this critical question suggests the advantages found in inner city will have a major influence on business decision-making not the incentive program that has been suggested in this research.

> Other factors with far greater impacts on cost or profitability, such as wage levels, skill levels, utility costs, accessibility of raw materials and markets, and regulatory stringency, are far stronger determinants of location decision and economic growth. [Ref. 51]

2. What are the competitive advantages of conducting business in the inner city?

All participants provided a number of advantages found in the inner city. Some of those advantages have already been mentioned in remarks made in question one.

Research indicated that all participants cited the following as advantages as <u>unique</u> to the inner city: *access to transportation, access to markets,* and *proximity to customers.*

- *<u>Access to Transportation</u>*: In the spring of 1997, the city of Chicago conducted a survey with Chicago urban businesses on the effectiveness of Chicago's Empowerment Zone (EZ) program. Of the 50 businesses that responded to the survey, access to transportation was the top advantage of conducting business in the city. Over 50 percent of the businesses remarked that access to transportation was "critical" or "important" to their survival. [Ref. 53]

Attracting businesses by improving infrastructure and promoting the genuine advantages of the inner city was stressed by Alicia Diaz, Assistant Director of Grant Management for the Office of the Mayor of Detroit. Ms. Diaz remarked:

> "Investment in the city has been substantial because land is cheaper and Detroit is the last major mid-west city that has access to international river ways. Furthermore our city is in the midst of finishing a billion-dollar expansion of the metropolitan airport which will attract businesses that conduct international trade." [Ref. 52]

- *<u>Access to Markets</u>*: Professor Michael E. Porter is founder of the Initiative for Competitive Inner City. The goal of this not-for-profit organization is to foster healthy economies in America's inner cities that create jobs, income, wealth and economic opportunities for local resident. Professor Porter said, "An inner city location can offer a competitive edge to logistically sensitive businesses that benefit from proximity to downtown and concentrations of companies." [Ref. 55:p. 3] Karen Salmon, Executive Assistant to the Mayor of Chicago, spearheaded the recent survey of Chicago urban businesses' remarks on the effectiveness of Chicago's EZ program. Her report cited proximity to time or space sensitive businesses serving the downtown customer base as a primary competitive advantage in Chicago's EZ. [Ref. 53]

- *<u>Proximity to customers</u>*: The consumer market of inner city residents represents the most immediate opportunity for inner city-based entrepreneurs and businesses. "High population density translates into large local market with substantial purchasing power. Inner city based businesses that serve this demand will have an advantage over most distantly located establishments because of their proximity to customers. [Ref. 55:p. 4]

3. What are the competitive disadvantages of conducting business in the inner city?

Nearly 95 percent of the participants cited higher costs (land, building, utilities, insurance, taxes, real estate) and poor infrastructure as primary disadvantages of the city. They also stated that the higher costs stemmed from the higher rate of crime in the inner city. According to Chicago EZ businesses interviewed, crime was the top barrier with burglary being the most common problem. Almost half of the all EZ businesses interviewed cited poor infrastructure or parking problems as a disadvantage of their present location. [Ref. 53.]

Fabio Sampoli, Senior Vice President of the Greater New Haven Camber of Commerce, stated, "taxes are higher in the city than in the suburbs, therefore companies tend to move out of the city." [Ref. 57] Amrina Laverdy, Executive Director of the Latin American Management Association declared, "Security problems and high insurance costs are disadvantages of the inner cities. Insurance companies in the cities are not receiving assistance from the government or other organizations. There is not any stimulus for them to reinvest in the community."[Ref. 58]

Tony Robinson, President of the Minority Business Enterprise Legal Defense Education Fund, stated that "Red-lining" was a common disadvantage found in the inner cities.

> Certain areas in the inner city are predominantly made up of minorities. Decisions are made to not invest actively in those areas. Evidence of this can be seen in banking. Some banks do not lend money to inner city residents and the banks do not invest back into the community. Major retail businesses have done the same. They tend to shy away from locating back into the inner city. Why? Race, crime and underemployment of the workforce. [Ref. 56]

Don Holbrook, Executive Director of the Red Wing Port Authority, said environmental issues are another disadvantage of conducting business in the inner city. The issue of "brownfields," an environmentally contaminated area, is a serious problem in America's urban areas.

> "Central cities are full of brownfields, these lands have been contaminated by industrial sites since the 1950s. Now a new company that moves into the area is enduring an environmental liability and is now contributing to the problem. Therefore, they will have to pay for the redevelopment and clean up of the area. Contamination costs will take millions and millions of dollars to remediate!" [Ref. 60]

Alicia Diaz said the number one problem that the city of Detroit is challenged with is the education level of the workforce. Additionally, "Detroit is experiencing a 'brain-drain,' that is individuals who achieve educational success and move out of Detroit instead of reinvesting in their community." [Ref. 52]

Lack of skills and education of the workforce in the inner city was cited as the most common disadvantages found in our urban areas. This issue is discussed in further detail in the question seven.

4. What types of industries in the inner city will a Federal contracting incentive program be most advantageous for in the inner city?

- **White Collar**
- **Blue Collar**
- **Both**

Of the 32 participants, four participants (two manufacturing firms and two CBOs) indicated both white-collar and blue-collar industries would do extremely well in the inner city. Twenty-eight indicated just blue-collar industries would take advantage of this program while zero participants believed just white-collar industries would thrive.

It was considered by many participants that a lack of education and training of many residents from the inner city was a compelling disadvantage to the success of many white-collar industries. As previously mentioned, this disadvantage of an uneducated labor force is looked at further in question seven. A "white-collar industry" is defined in this research study as an industry that employs workers with technical proficiency in high technology professions such as engineering, information technology, and management consulting firms. A "blue-collar industry" is defined in this research study as an industry that employs lower skilled workers for manual labor or non-management level positions in areas such as, manufacturing, construction, trucking, delivery services, and retailing.

Roger Mody, CEO of Signal Corporation, an information technology firm, indicated that, "an incentive package will work given the type of industry you earmark in the inner cities like wholesale manufacturing, retailing, construction. Industries such as a high tech professional service like, IT, will experience a challenge in recruiting high-skilled workers." [Ref. 59]

However, Austin Fitts, CEO of Hamilton Securities Group truly believed white-collar industries would do well in the inner city. From her personal experience at recruiting employees from the inner city she proclaimed white-collar industries thrive in the inner city because the workers are eager to learn and exited at the chance to prove themselves. " I have employees working for me who we recruited and trained that after a few years can demand a salary from competitive firms of up to $60,000 a year." [Ref. 62]

Blue-collar industries take advantage of the easy access to major transportation hubs which provides delivery services with an excellent competitive advantage for trucking, sea or air transport. This advantage has produced a dense concentration of

processors, caterers, truckers, wholesalers, distributors, and other suppliers in the inner cities. [Ref. 61]

Barry Corona was one of the participants who supported both white and blue-collar industries in promoting economic development in inner cities. He said that his researcher his company was a manufacturing high tech company. He also mentioned that as a manufacturer, "he builds value vice companies that push paper (referring to white-collar service industries)." He enthusiastically endorsed an aggressive initiative like the HUBZone bill but vehemently opposed economic development policy that favored "white-collar" industries in the inner city.

> All set-aside programs are geared toward white-collar industries, paper pushers who produce nothing. A bill like the HUBZone program is key. White-collar industries should not be asked by policy makers for comments on formulating economic development policy since they do not produce anything! My company builds missiles and aircraft parts for major weapon systems, what can a service industry deliver in terms of products for the military as well as employment opportunity in these areas of economic distress. Initiatives like the HUBZone bill will stimulate manufacturing and create value for the country. Any leading economist will tell you, that you can't make money and can't defend yourself selling hamburgers and paper. I am impressed with DOD and the Federal Government are taking the lead in this and not allowing ourselves to be steered by the people in the 8(a) program who just push paper. Why go to them for opinion, if you are talking about creating touch labor jobs in the inner city, you better talk to people who do that. Electrical engineers are not on the unemployment line in the central cities. [Ref. 43]

5. What is the underlying motive of this type of program?

- **Political**
- **Other**

Of the 32 participants, 17 believed the motive of this type of incentive program was political, the remaining 15 suggested other motives, such as the Federal Government

truly making an effort at revitalizing the inner cities. All the special interest groups, all the economist/university professors, four CBOs, four firms, and two Federal agency organizations believed the motives were political. Five firms, four CBOs, three city council organizations, two Federal agency organizations and one economist cited political motives as the main driver of this issue.

The 15 participants firmly believed that a significant impact can be made if the business sector is incentivized to locate and hire residents in depressed areas of the inner cities of our country. Glynn Loope commented that programs such as HUBZone and E0 13005 are not viewed as just another Federal jobs program.

> I do not view this type of program as another federal jobs program. As we all know, the federal government is a huge consumer of goods and services. These proposals seem to stimulate the decentralizing of acquiring those essential elements of the government process. This includes needs of the military, as well as, federal infrastructure projects and even basic government operations such as data processing. [Ref. 44]

In her testimony before the Senate Committee on Small Business and in our phone interview on May 2nd, 1997, Sandra Newman, CEO of Raritan Container, an urban-based manufacturer of corrugated boxes and a distributor of packaging supplies in New Brunswick, New Jersey, strongly endorsed the motives of such programs. She employs 40 people. Ms. Newman believes Federal incentive programs, like the HUBZone bill speaks to the immediate need for jobs for inner city residents.

> Entire communities would benefit by creating meaningful incentives for small companies to operate and provide employment directly within America's most disadvantaged inner-city neighborhoods and in areas of high unemployment and poverty. [Ref. 32]

The remaining 17 participants believe these incentives to revitalize the

inner city are just another ploy by public officials. David Littman, Vice President and Senior Economist of Comerica Bank of Detroit, Michigan, described the political influences attached to such programs. He says that politicians, "Are providing you an artificial inducement to hire these people that you would not have originally hired. It is a force-feed process—here is the quota and here is what you are allowed to do." [Ref. 54]

As noted by Peter Enrich, Associate Professor at Northeastern University:

> In any case, elected officials are often as interested in the "symbolic content" of their actions as in their concrete effects. By taking visible steps to encourage economic growth, they can take credit for subsequent economic successes, whatever their actual causes and avoid blame for any losses of jobs to other states that otherwise would have attributed to them is they had failed to act. From a political perspective, doing something is almost always better than doing nothing, particularly in regard to an issue about which voters care deeply. [Ref. 51:p. 394]

Enrich further claims that in a political atmosphere dominated by concerns about economic vitality and jobs, elected officials face intense pressure to engage in the incentive competition.

> Moreover, the incentive programs, even if they do nothing else, can always be expected to improve the state's "business climate"- that is, the business community's perception of the state responsiveness to business concerns, a factor that the business community continually assures elected officials is central to business location decisions. [Ref. 51:p. 393]

Given the idea that promoting economic development in inner cities with Federal contracting incentives will be a program in existence for the next 10 to 15 years, answer the following questions:

6. For what size business should this program be earmarked?

- **Large**
- **Small**
- **Both**

Seventeen of the participants suggested only small businesses should be included in the program while 15 implied both large and small businesses should participate in the program. Small business preference was indicated by five businesses, all four economists/university professors, four CBOs, two special interest groups, and two Federal agency organizations.

In response to comments regarding the guidelines of the Empowerment Contracting Program as well as this research study, Michael Rielly, Director of Human Resources of Lockheed Martin Communication Systems of Camden, New Jersey, proclaimed that these areas of economic distress will benefit from both large and small business activity.

> The notion that "large business" activity is at the expense of "small business" fails to recognize that large and small businesses seldom compete in the same marketplace, but rather compliment each other in a symbiotic relationship. Healthy economies have a balance of small and large businesses and it should be the intent of these guidelines to encourage a variety of forms of economic activity. [Ref. 63]

Tom Kolis, Small Business Specialist at the NASA AMES Research Center in Moffet Field, California, believes both large and small businesses will play a critical role in promoting economic development in inner cities. Mr. Kolis states, "The nature of the industry will determine the size of the business in the HUBZone or EZ. Competition for

Federal contracts would be advantageous to the Federal Government in terms of getting the most qualified business to carry out the goals of the program." [Ref. 64]

Tony Robinson also supported large and small businesses participating in these initiatives based his opinions on the competitive advantages found in the inner cities. He claims,

> Certain types of companies, big or small, in certain types of industries might be incentivized based on the advantages provided by the inner city. For instance, if you are a service provider, proximity to your customers is critical, if you are a manufacturer, access to transportation would be your motive. [Ref. 56]

Advocates of a small business preference in Federal contracting incentive programs believe small business is the key to an economic development program focused on generating jobs and sustaining growth in the community. Samuel Carradine, Executive Director of the National Association of Minority Contractors believes small business is the key to this effort since they tend to employ the greatest percentage of workers. Small-business set-asides do work. Statistically, studies have indicated they employ the greatest percentage of workers in the country. This is the nature of small business, whether it is in an area of economic distress or not. [Ref. 65]

Barry Rubin concurs with Samuel Carradine's small business perceptive. He went even further to say:

> Small business will provide more self-sustainment in the community. Small business has much higher risk associated with it but you have greater diversity and more opportunity to obtain jobs than what large businesses provide. Furthermore, this incentive program will ensure you, "don't have all your eggs in one basket". Small business will generate more capital to stay local, ownership is usually local, owners usually re-invest part of their profits back into their community. [Ref. 45]

Pamela Loprest, Project Manager for the Urban Institute, mentioned certain Government contracts cannot be filled by small businesses due to the size and complexity of the contract. However, she indicated, "If the goal of the incentive program is to encourage formation of business and employment, policy makers should opt for small business. Local owners tend to hire people like themselves from the community therefore re-investing in the local area." [Ref. 66]

Glynn Loope stated the following with respect to small business activity:

> Across the country, over 15,000 organizations claim a role in economic development and job creation. This is why many economic development practitioners and theorists suggest the way to truly grow community wealth is to spawn small business, with entrepreneurs and struggling enterprises in economically distressed areas. [Ref. 44]

A small firm strategy to promote economic development in the inner city can be summarized by the following excerpt from a study conducted in 1994 that reviewed the effects of geographically targeted urban economic development strategies.

> In addition, proponents favor small firms over larger ones. Small firms are viewed as more likely than large firms to hire local residents and unleash their latent entrepreneurial energy. Small firms are also preferred because of the greater likelihood that they can use existing building; large firms typically need to build their own customized facilities. [Ref. 1:p. 196]

7. **What percentage of the workforce should companies participating in this program be required to hire from the inner city?**

   - **35 percent or more**
   - **25 percent or less**

Nineteen of the participants indicated that 35 percent or more of the workforce should come from the inner city while the remaining 13 indicated 25 percent or less. Three economist/university professors, three CBOs, one special interest group, and six firms believed 25 percent of the residents in the designated area should be employed by a

company participating in this program. All four city government organizations, all four Federal agency organizations, five CBOs, three firms, two special interest groups, and one economist supported a requirement that 35 percent or more of workforce must be from the inner city.

The participants who indicated that 25 percent or less of the workforce should be employed by the inner city based their opinions on the lack of a skilled labor force. This competitive disadvantage is an obstacle many companies are faced with when conducting business in the inner city. Inadequate training programs, unsatisfactory employee education levels, and poor or zero work ethic constrain companies from hiring many from this eager and plentiful pool of labor.

Jennifer Barton, Project Manager for Lockheed Martin Communication Systems, Camden, New Jersey, declares:

> Moving into a severely economically depressed area and required to employ a significant amount of the employees from the area is a concern for me. It would be difficult to provide employment opportunities when a significant number of the employees need college or masters degrees and the area is generally unskilled and uneducated. [Ref. 67]

Don Holbrook indicated the lack of work ethic of many residents of the inner city is a challenge many companies must face when locating operation to the inner city.

> The lack of work ethic is a major workforce problem in the inner city. Many of these people are unemployed and underemployed for certain reasons. It is not that all residents in the inner city lack the motivation and drive to work but many companies evaluate this issue in such a manner. [Ref. 60]

Brent Evans, Executive Vice President of Mid-Tech Corporation of St. Louis, Missouri, cited the work ethic dilemma as a challenge many companies do not want to confront. He indicated:

> A contracting incentive program should require 25 percent or less of the workforce because companies will not be able recruit enough qualified people in the inner city to comply with a contract provision requiring a higher percentage. Some residents do not understand what a work ethic entails. They can't use a checkbook, do not review bus schedules or comprehend the responsibility of being at work, on time and five days a week. [Ref. 68]

Samuel Carradine indicated that requiring 35 percent of the workforce come from residents living in a certain area of the inner city will be constrained not by the lack of skills of the workforce but union issues. He asks, "Is the contract requirement exempt from union requirements? If it is a federal job that is unionized, you are not allowed to specify hiring with respect to union contract provisions". [Ref. 65]

Philip Kasinitz noted that an economic development program that requires job opportunities in distressed urban areas be granted to local residents does not guarantee success. Few local residents will be hired if firms require skill levels not generally present in the local population or if they continue to fill jobs by relying on existing labor market networks from which inner city residents are isolated. [Ref. 1:p. 196]

Tom Delfo summarized question seven by stating the following:

> These programs will find the lack of qualified personnel to be the most limiting factor. My experience with local hire programs, while well intentioned, is that they do not work terribly well. Private firms often agree to local hiring as a condition to receive funding or preferences. However, over time these programs end up with the following results: (1) the firm abandons the program due to inability to find employees from the target location with appropriate skills and/or experience, or (2) the firm hires individuals from an inner city location who in turn move to another neighborhood or community once they have accumulated enough financial resources to do so. [Ref. 48]

8. **What percentage of the contracted work should companies participating in this program be required to complete in the inner city?**

- **50 percent or more**
- **25 percent or less**

All participants with the exception of one believed 50 percent or more of the contract should be completed in the inner city. The primary reason why the one participant objected to this percentage was due to the lack of skills found with many residents of the inner city. The remaining 31 participants believed a required provision to conduct 50 percent of the contracted work in the inner city would produce immediate results in terms of economic activity and development in the distressed area.

9. **To what extent will this type of program have in promoting economic development in the inner city?**

- **Large**
- **Moderate**
- **Minimal**

Four participants (one large business, one CBO, one university professor and one city government organization) indicated the program will have a substantial impact. Thirteen indicated a moderate impact while the remaining 15 cited a minimal impact. Six CBOs, three firms, two city government organizations, and two Federal agencies indicated moderate impact. Five businesses, three economist/professors, three special interest groups, two CBOs, and two city government organizations indicated minimal impact on spurring economic development in the inner cities.

The participants who believed the program would have a large impact on the economic development of inner cities cited reasons similar to the ones listed in question one. These reasons included, the financial incentive tied to the Federal contracts, the

immediate results anticipated, and the fact that an area has been designated by the Federal government to receive Federal assistance are issues supporters believe will improve business activity in the area. As Barry Rubin said:

> For the most part, establishment of a federally assisted zone provides a synergistic event that promotes improvement in zone's business climate. Once the zone has been established, enthusiastic participation in zone activities by a core of entrepreneurs and residents creates an aura of success that is apparent to firms both in and outside the zone. This becomes a self-fulfilling attitude—a community that looks and acts successful will become successful—and in time spur self-sustaining economic development. [Ref. 45]

Almost all of the participants who indicated that the program would have minimal impact believed this program was just a tool to assist the Government in promoting economic development. They indicated disadvantages found in the city which were cited earlier in this chapter are too great to overcome with just one type of economic development program. Tony Robinson cited lessons learned from previous initiatives to promote economic development in inner cities with Federal contracting incentives as a reason why this type of program would have minimal effect on the community:

> The authority contained in Section 8(a) of the Small Business Act was first used to support a "Test Program" initiated as a result of the civil disturbances during 1967. The overall program, commonly referred to as the "The President's Test Cities Program", was under the special direction of the Department of Commerce and Labor, relying primarily on support from the Department of Labor to provide training grants to companies hiring and training the unemployed and underemployed. <u>The initial intent behind utilizing SBA's 8(a) authority was to offer government contracts on a non-competitive basis to companies agreeing to locate in or near "ghetto areas", and to hire the unemployed and underemployed</u>. <u>8(a) contracts were not restricted to minority-owned firms, but were offered to any small firm willing to hire and train and train the unemployed and underemployed in the designated test cities. This effort was not successful, and did not result in the desired plant relocations, hiring and training.</u> [Ref. 36:p. 4] [Emphasis added]

David Littman stated he was skeptical that initiatives, like the Empowerment Contracting Program, will actually promote job creation in areas that need it most. He said, "Government preferences send a message that targeted businesses are not competitive, that they are not able to succeed without favoritism from Washington and the politicians...and that may not be true whatsoever now, in these times and these places. [Ref. 72]

Tom Dalfo summarized the minimal impact of this program on the economic development of urban areas by stating the following:

> I believe contracting preferences will play a rather small role in the economic development of urban areas. The dollar amount of the incentives (which in my opinion are capped far too low to have a serious impact) and the restrictions placed on them with respect to local hiring will prevent widespread application of programs like the Empowerment Contracting and HUBZone programs. I believe these programs will be of marginal assistance for most firms and will prove most helpful in retaining or expanding firms already located in urban areas rather than attracting firms outside the urban areas. [Ref. 48]

The remaining participants who indicated moderate impact of the program clearly believed the program alone would play a rather small role in the economic development of the inner city. However, if tied to other policies geared to improving the infrastructure of the inner city thus making the area more attractive to businesses, then the program would play a rather significant role in spurring economic development in inner cities. Mike Andrews summarizes this perspective in the following statement:

> Evaluation incentives to encourage business activity in areas of general economic distress must include policies and procedures that promote cost effective, efficient, and quality workforce development strategies that build skills and knowledge among employees, companies and local communities. [Ref. 69:p. 2]

10. Recommend criteria that needs to be considered in order to successfully implement this program?

Although posed as a broad question, surprisingly the researcher realized that 75 percent of the participants believed the success of this program hinged upon on a cooperative economic development approach between the public and private sector. The remaining 25 percent recommended methods of successfully employing Federal contracts with respect to contracting requirement such as the size of the business and percentage of employment of area workforce.

Tom Kolis recommended that an interface between the community, private sector and Government needs to be established so everyone is reading off the same sheet of music. Mr. Kolis said, "Uniformity in communication and rules are paramount, if you can't measure it, you can't manage it." [Ref. 64] He provided policy-making tips to ensure success of this program:

> I believe policies must be established! Restrict the size of the business depending upon the number of businesses who satisfy the eligibility requirements for that individual area. Provide the prime contractor the discretion to which he/she subcontracts to. Subcontracting is too complicated for the government to oversee. Have implementation of the program at the federal level therefore there is less opportunity to politicize the process if only one level of government is monitoring and implementing the program. [Ref. 64]

Barry Rubin indicated that all the key stakeholders need to be involved in this initiative in the early phases of development. If they have an active role in the development they will participate. He recommended:

> Policy makers must establish a positive business environment—building infrastructure (roads, training, education), focus on self sustaining growth. The initiatives alone will not be significant unless it is part of a strategic plan for the community. [Ref. 45]

To ensure the business needs of both large and small businesses are being satisfied, Amrina Laverdy recommended that a designated area (EZ or HUBZone) contract should have written provisions that require the prime contractor to subcontract for goods and services from companies operating in the inner city. Have it written in the contract that the prime contractor must do 50 percent of the contracted work in the designated area of economic distress and require 50 percent of subcontracting go to small business located in the inner city. [Ref. 58]

Paul Chann, Procurement Center Representative, SBA of San Francisco also indicated a potentially successful implementation recommendation for this program would be to establish prime contractor subcontracting guidelines in these designated areas. In his comments to DOC on the Empowerment Contracting Program, Paul said:

> Establish a requirement that mandates small, small disadvantaged, and women owned small business subcontracting plans identify whether there are enterprise/empowerment zone in the vicinity of the prime contractor's principal sites of contract work performance, and if there are such proximate zones, what actions the prime contractor will take to give zone certified firms access to compete for subcontracting opportunities. [Ref. 70]

Mike Andrews, Executive Director of the Alaska Human Resource Council, Office of the Governor of Alaska, recommended an in-depth approach to development and improvement of a policy to encourage skills and training programs for residents of targeted communities. He recommended:

> Where practical, Federal procurement policies and regulations should give preferences to contractors and employers that utilize existing local or national "earning and learning" elements such as: federal and state registered apprenticeship, state certified vocational education, business and/or industry internship and mentorship programs, on-the-job training, and school-to-work initiatives. With such procurement policies in place, employers would be motivated to coordinate and link with local workforce

> development initiatives and promote local economic development strategies. [Ref. 69:p. 2]

More than one-half of the participants believe an active player in promoting economic development the in inner cities rests with Community-Based Organizations (CBOs). CBOs are nonprofit, tax exempt corporations that undertake economic development and social service projects. [Ref. 45] CBOs, with their networks both in the community and in the private sector, can play an important role in helping overcome these barriers and connecting inner–city residents to nearby jobs. [Ref. 55:p. 15] Paul Chann stressed the important roles that CBOs play in promoting development in areas of general economic distress. These authorities are best positioned to certify firms, which should be afforded preferences, if preferences are to be given. [Ref. 70] Barry Rubin summarized the importance of the CBO/Community Development Corporation by stating:

> These organizations have succeeded in revitalizing depressed areas with minimal expenditures of public funds. Their success often is attributed to their use of an entrepreneurial/risk-taking approach to projects, their targeting strategies, their **public/private partnerships**, their efficient use of local resources, and their working with small businesses. [Ref. 45]

These designated areas must be managed actively by an organization with a professional staff exclusively assigned to promoting economic development in the inner city. Rubin stressed, the contribution to management structure becomes obvious when you consider that lack of management skills has been cited a primary cause of for business failure. [Ref. 45]

In recommending an approach to promoting economic development in the inner city, the idea of a public/private partnership to overcome the disadvantages posed by the

inner city was a common theme voiced throughout the researcher's interviews. Tom Dalfo's comments concerning this idea can summarize the beliefs of many supporters of a public/private partnership:

> I believe a partnership between the private industry and the federal government is not only a realistic solution to addressing economic development in inner cities, it is the only solution, which can hope to resolve the lack of economic activity in these areas. The private sector will not willingly make major investments in inner cities without substantial incentives from the government. The cost of doing business in the inner city is simply too high for many firms to justify the investment. Firms will locate where the return on investment will be the highest. The increased costs associated with inner city development will prevent investment in all but a few industries, e.g. shipping. Conversely, government will not be able to make the investment and create the jobs necessary to revitalize urban areas without the private sector. [Ref. 48]

C. STUDY CONCLUSIONS

From the information the researcher obtained from the 32 phone-interview surveys, the following conclusions have been reached:

- A program to spur economic development in the inner city with Federal contracting incentives will not attract businesses to locate to areas of general economic distress. For this type of program to have a large impact in the inner city it must be tied to a set of other economic development strategies that will attract businesses to the designated area. Businesses will locate based upon competitive advantages it sees in the inner cities

- The program should include large and small business. However, contracting provisions need to be established to satisfy small and large business concerns.

- The Federal Government cannot achieve this goal of economic development in the inner city alone. It needs active participation from the private sector and the community. Implementation and enforcement of the program will pose a significant challenge to key stakeholders participating in the program

- In order for these initiatives to be successful, they need to be earmarked for white and blue-collar industries that thrive in the inner city.

- An uneducated, unskilled workforce found in the inner city remains a continuing primary disadvantage of the inner city

- Because the goal of this initiative is promoting jobs and stimulating new business investment, it must be recognized that politics and a general need for change will ensure this issue remains a national agenda.

D. SUMMARY

This chapter described feedback the researcher attained while conducting over two months of phone interview surveys with organizations familiar with the Federal Government's most recent initiatives to spur economic development in America's inner cities. Based upon the information gathered from the surveys and the latest available information on urban economic development policies and approaches, the researcher made several conclusions with respect to this issue.

Chapter V provides the analysis supporting the researcher's conclusions. Furthermore, from the information gathered up to this point, a practical and realistic policy-making approach to employing Federal contracting incentives in order to promote economic development in America's inner cities will be formulated.

V. ANALYSIS AND RECOMMENDATIONS

A. INTRODUCTION

In the past two years, the Empowerment Contracting Program (EO 13005) and the HUBZone Act of 1997 (S. 208) have been the most recent attempts by U.S. policy makers to promote economic development in distressed urban and rural communities. In an effort to generate jobs and stimulate business investment, these two initiatives apply Federal contracting incentives as the vehicle to attract or retain businesses in the EZ or HUBZone. In order to be eligible to receive contracting preferences, a firm must abide by the provisions established in the contract incentive program. These provisions range from employing a certain percentage of the labor force to completing a certain percentage of the contracted work within the designated area.

This study attempted to answer questions surrounding the potential impact these initiatives would have in spurring economic development in America's inner cities. At the end of Chapter IV, the researcher rendered conclusions concerning this primary research question, based upon the information gathered from the phone-interview surveys and the latest available information on urban economic development policies and approaches. In this chapter, the researcher supports the study's conclusions with analysis of the information obtained from this study. In an effort to formulate a sound policy that considers attributes derived from both initiatives, as well as material from the previous Chapters, the researcher recommends policy-making alternatives to applying Federal contracting incentives in the most effective way to promote economic development in urban communities of America.

B. POLITICAL OR NATIONAL AGENDA?

Initiatives such as the Empowerment Contracting Program and the HUBZone Act of 1997 will be in the national spotlight for at least another decade. Both initiatives strive for community development and job creation as a means to revitalize the inner city. Community development and "welfare-to-work" initiatives are high profile issues that concern every American, which for politicians, add up to votes. The researcher does not proclaim that such an initiative is truly political in nature. The researcher believes policy makers have a moral and legal obligation to look out for the needs of the people in their respective community. However, these issues which voters care deeply about can spell potential exploitation by elected officials. In addition to receiving high public support, community development and job creation are two public issues that surprisingly generate bipartisan support in Congress. The researcher believes Democrats have always supported economic development efforts such as this. Republicans have recently come on board. Senator Bond, a Republican from Missouri, sponsors the HUBZone Act of 1997.

The mere attempt by elected officials to improve the economic well being of their communities is looked favorably upon by most voters. A designated area such as an EZ or a HUBZone holds "symbolic value" to many residents of that area because it demonstrates to the residents that the Government and the elected official from that region are taking an interest in the welfare of their community. As stated by Peter Enrich, "From a political perspective, doing something is almost better than doing nothing, particularly in regard to an issue about which voters care deeply." [Ref. 51]

Seventeen of the 32 participants surveyed believed initiatives designed to promote economic activity in America's inner cities with Federal contracting incentives has more political value than economic achievement. The researcher believes these initiatives have true economic value but feels political bias with regard to program guidelines will hamper their effectiveness. The researcher believes this type of initiative will continue to be a national issue since its goals are aligned with public interests and this economic development strategy has not been attempted or tested until now. Believing these types of incentive programs will exist for at least the next ten years, the researcher, in the following sections of this chapter, addresses issues that play an influential role in shaping policy in efforts to spur community development successfully and generate jobs in America's inner cities.

C. IMPACT OF THESE INITIATIVES

Promoting economic development in the inner cities of America with Federal contracting incentives, will have minimal effect in attracting businesses to locate the economically distressed area. As indicated by the state enterprise zone experience and by 30 participants in the survey, companies will not locate their operation to inner cities based solely on tax or non-tax incentives. The researcher believes firms will be attracted to the inner city based upon two issues:

1 The competitive advantages of the inner city.

2 An economic development strategy that makes the inner city attractive to businesses despite its disadvantages.

The first issue is quite obvious. Private firms tend to move naturally to areas where it expects to make a high return on investment or profit. The material gathered for

this study indicates business location depends largely on factors outside governmental control. Based upon the type of industry in which a company operates in, access to transportation, access to markets, and proximity to customers are generally perceived as key advantages found in the inner city.

The second issue is more complex. The study has indicated that these initiatives must be connected to other efforts that attempt to revitalize the inner city in order to have more than a marginal impact. These other efforts should include Federal, state and local government initiatives that address the disadvantages found in the inner city. An economic development strategy needs to be established that will make the inner city more attractive to private firms. The researcher believes this can be possible if policy makers provide funding for the following five inner city development efforts:

1. Rebuild the infrastructure of the inner city
2. Revamp unusable land (brownfields)
3. Upgrade training programs that offer specific skill level training for jobs earmarked for inner city industries
4. Improve public safety in the inner cities.
5. Upgrade school systems in the inner cities.

The following two points should be included in this urban development effort:

- Provide tax and non-tax incentives to companies to locate, hire inner city residents and perform contracted work in the inner city. For instance, to overcome the costs of doing business in the inner cities, some type of tax credit be developed to allow these areas to compete on an "even footing" with suburban communities.

- Streamline regulations for conducting business in the inner city.

D. THE WORFORCE OF THE INNER CITY

The researcher believes inadequate training programs, unsatisfactory employee education levels, and poor work ethic will be the primary obstacles hindering many

companies from hiring residents in this eager and plentiful pool of labor that exists in the inner city. Depending upon the industry that is located in the inner city, recruiting a quality work force will be challenging for many private firms.

The goals of EO 13005 and S. 208 are to generate jobs and new business investment. In the hopes of spurring economic activity in the inner city, the researcher believes companies that are awarded these contracts based upon contracting preferences should be required to employ a high percentage of the workforce from the designated area. As clearly stated in the initiatives, a primary goal of this type of program is job creation. If a company does not employ a significant number of the local workforce to complete the awarded contract, then the program's motive is futile.

Senator Bond's HUBZone bill aggressively addresses this issue by making contracting preferences available only if a small business is located in the an economically depressed area and employs at least 35 percent of its workforce from a HUBZone. The researcher believes the Senator's bill avoids bureaucratic roadblocks that have delayed the eligibility processes of previous set-aside programs such as the 8(a) program. If a small business meets the eligibility requirements, the business is automatically qualified to receive Federal Government contract benefits. For more information concerning the HUBZone Act of 1997, refer to Chapter III, pages 32 to 35.

Furthermore, in keeping with the goals of this type of initiative, it is recommended that another eligibility requirement be established prior to awarding firms contracts based on the contracting preference of this program. Concurring with 30 of the 31 participants in the survey, the researcher believes a firm should be required to perform at least 50 percent of the contracted work within the designated area. This is a clear-cut

requirement that truly makes sense. In order to encourage new business investment in the designated zone, it seems logical that business activity will be enhanced if contracted work must be performed in the designated area. The researcher applauds Senator Bond's effort in this matter. The HUBZone bill specifically states that one of the three eligibility requirements be that a small business perform at least 50 percent of a contract in a HUBZone unless the terms of the contract require that performance be elsewhere.

The researcher believes President Clinton's Executive Order for Empowerment Contracting falls short of effectively impacting business development via job creation as compared to Senator Bond's HUBZone bill. The researcher feels the Executive Order provides too many ways for a large or small business to be eligible for the contracting preferences, which spells possible abuse by potential offerors bidding for valuable contracting preferences. Referring to Chapter III, pages 27 and 28, businesses seeking pre-qualification are based on three detailed requirements. To summarize, a qualified eligible business means a small or large business that meets one of the following three criteria: employs a significant number of residents, has a significant physical presence, and has a direct impact on generating significant economic activity in areas of general economic distress. Businesses seeking self-certifications of eligibility must prepare a detailed description of its plan for achieving the requirements of the program. Pages 28 and 29, of Chapter III, detail what the description must identify. Furthermore, when monitoring the impact of business development, a sample of businesses receiving contracts under the program would be examined with respect to five issues as listed on page 31 of Chapter III.

In addition, the Executive Order's eligibility requirement with respect to contracted work performed in the designated area is too ambiguous and complex. The researcher believes the content ambiguity will lead to potential abuses by firms bidding for these valuable contracting preferences. The Executive Order states that a business will be considered eligible if it has, "a direct impact on generating significant economic activity in the area." The Order then lists two long paragraphs on what this entails. For further review, refer to Chapter III, page 28.

The researcher believes one approach to alleviating the workforce problem is for the Federal Government to encourage skills and career training programs for residents of targeted communities as a means of ensuring long-term sustainability as well as the building of a knowledge base to promote fair competition and business development. Samuel Carradine suggests, "A good entry point for encouraging such training would be through the development of an evaluation preference scoring mechanism that motivates bidders' to incorporate skills and career training as in-house priorities." [Ref. 18:p. 2].

The researcher also suggests a publicly subsidized program be established which allows businesses to hire and train employees from the inner city at little or no cost will help address the problem many businesses encounter in the inner city when recruiting a quality workforce.

These training programs need to create not only better jobs for inner city residents but jobs that effectively target low-income populations. Policy-makers must be realistic on how effective a training program will be provided the educational level and work experience of the labor force that these programs are designed to enhance. The private sector in conjunction with Community-Based Organizations (CBOs) can address the

workforce problem by targeting training programs to develop the specific skills training necessary to affect the successful transition from welfare to meaningful work.

1. Role of the Private Sector

The private sector will invest in the inner city because of the competitive advantages the inner city already offers or if it feels the Government (Federal, state or city) is making efforts to make the inner city more attractive to businesses. Making the inner city more attractive to businesses will be the substantial incentive that will lure firms to the inner city.

With that in mind, the private sector in conjunction with CBOs should provide the job training and skill development required for residents of the inner cities. As employers, private firms know better than any other group what skills are needed to successfully perform jobs within their companies. As a result, the private sector should provide much of the job training. This will ensure a match between skills learned and skills needed. A plan of action should be adopted into the Federal contracting incentive program that engages the private sector to create and certify training programs for residents of the inner city.

2. Role of CBOs

CBOs are non-for-profit, tax exempt entities that undertake both economic development and social service projects. "They deserve much credit for helping to create the conditions under which the private sector would consider investing." [Ref. 55:p. 14] These organizations, with their connections in both the community and in the private sector, can play an important role in helping overcome many disadvantages of the inner city and thus connecting inner-city residents to nearby jobs. CBOs have a keen

understanding of the wants and needs of local businesses and through first hand experience dealing with the local community have a better understanding than most organizations on how to encourage business growth and investment. Michael Porter cited a case study mentioned in his *Harvard Business Review* article, "The South Brooklyn Local Development Corporations played an important role in connecting local residents to jobs in the Red Hook industrial area, by developing relationships with nearby businesses and screening and referring employees to them." [Ref. 55:p. 15] Barry Rubin said, "Their {CBOs} success often is attributed to their success of an entrepreneurial/risk-taking approach to projects, their targeting strategies, their public/private partnerships, their effective use of local resources, and their working directly with small business." [Ref. 71:p. 103]

A CBO consisting of a professional staff exclusively assigned to promoting economic development in an inner city should be assigned the task of attracting new business to the designated area while assisting existing local business in creating more jobs and stimulating new investment in the community. CBOs can tie community development efforts to private sector investment that spells economic achievement for the designated area.

Based on their in-depth and unique knowledge of the inner city, CBOs should be given the authority to monitor and enforce the contract provisions as established this incentive program along with establishing and implementing training goals with the private sector. For instance, CBOs should monitor and ensure private firms that are awarded federal contracts based on contracting preferences continue to abide by

eligibility requirements in terms of employment of local residents or a percentage of contracted work completed within a designated zone.

Measuring the program's effectiveness in terms of a phased approach such as the method presently being used in President Clinton's Empowerment Contracting Program is a very intelligent method to measuring the program's effectiveness. Based on written feedback from private firms, community development advocates and city government organizations on the proposed guidelines for program implementation, the DOC decided to employ phased approach for EO 13005 in order to measure its effectiveness.

The phase approach consists of two phases. The first phase is 18 months. The goal of the first phase is to see if the Program is most effective luring current government contractors to distressed areas, luring businesses in growth industries to distressed areas, or encouraging sales for businesses located in distressed areas. The second phase of the program begins after the first phase of the program has ended and extends for a period of five years. At the end of this five years, the DOC in consultation with the agencies designated by the Executive Order will ascertain whether the program stimulated economic activity via job creation or new business investment in areas of general economic distress and benefited the federal procurement system. For more information on the phased implementation of EO13005, refer to Chapter III, pages 30 and 31.

The researcher believes this phased approach as written in the Executive Order is an effective management tool which CBOs in conjunction with a community development advisory council could use to measure this initiative's effectiveness in community development and job creation.

The establishment of this community development advisory council should consist of representatives from inner city businesses/entrepreneurs, local residents, community development advocates, and organized labor and city government. These participants represent the most influential groups in the inner city. Their input on ways to create jobs and stimulate new business investment will be critical to the success of such a program. For implementation purposes, each inner city will be required to have such a council if the inner city expects to be considered in the Federal contracting incentive program. This council should act as the decision making authority for the initiative's periodic evaluations concerning the program's overall progress in terms of management, administration, implementation, enforcement, as well as determining outcomes and outputs with respect to specific goals and guidelines directed by the Federal agency spearheading this Federally-funded effort. Their decisions will be influential in measuring and sustaining the success of this program.

3. Role of the Government

Government should attempt to remove the financial obstacles to economic development in the inner city in an attempt to place these areas on a comparable footing with suburban communities. The Federal Government must promote strong guidelines that encourage community human resource development in partnership with the private sector. In his comments on the guidelines for the Empowerment Contracting Program, Mike Andrews said:

> Using well considered evaluation credits and preferences for programs and funds, government can create an environment that strengthens the connection between private enterprise, schools, training providers, industry skill standards, technical knowledge, and federal and local workforce development strategies. [Ref. 69:p. 2]

The role of the Federal Government therefore rests in not on direct intervention and heavy reliance on operating subsidies to attract businesses, but on creating a favorable environment for businesses to flourish. As mentioned earlier in this Chapter, in order for this initiative to have more than a minimal impact on the economic development of the inner city, the development of a favorable business climate to attract private firms must be established. This will mean the state and local government working in conjunction with the Federal Government to provide funding that address the five inner city development efforts the researcher listed on page 70, which are believed to be critical to successful economic development for urban America.

With regard to establishing the Federal contracting incentive program, the role of the Federal Government should be to establish specific goals and minimal eligibility requirements for the program. The Federal Government should empower each state and city government to formulate eligibility requirements to achieve the specific goals a written in the Federal incentive progam, based upon the differing competitive advantages and disadvantages in each inner city of America.

E. SMALL OR LARGE BUSINESS

The researchers believes that the size of business should not be considered an eligibility requirement in order to receive a contract preferences for locating business activity into America's urban areas. Executive Order 13005 and S. 208 have the same goals of job creation and new business investment in urban areas of economic distress. In developing a policy that parallels these goals, the researcher declares that the type or nature of the industry will dictate the size of the business that will operate in the an EZ,

HUBZone or other designated area. The nature of the industry whether large or small will be attracted to the inner city based on the competitive advantages found in the urban area.

The HUBZone Act of 1997 contains a requirement that mandates a firm must be a small business to be eligible for Federal contracting preferences. There are benefits and drawbacks to this requirement. Research has indicated small businesses will generate more capital to stay local, tend to hire more from the local labor force that large businesses, and local owners usually reinvest some of their profits back into their community. Furthermore, studies have indicated that small business tend to employ the greatest percentage of the workforce. However, large businesses have the capital and flexibility to potentially have a greater impact on generating jobs and new investment in the designated area. Also, certain Government contracts, such as major weapons system development cannot be filled by small businesses due to the size and complexity of the contract.

An economic development program focused on generating jobs and sustaining growth in the urban community should not limit competition to one particular size of business. Limiting the size will in essence, limit the program from attaining its goals in terms of economic development in America's urban areas. Both large and small businesses should be invited to participate in competing for the contract preference. Competition for these contracts will be advantageous to the Federal Government in terms of getting the most qualified business to achieve the goals of the program in the most expeditious manner.

In order that small and small disadvantaged businesses receive their fair share of contracted work in these designated areas, a contracting requirement should be written into the program that addresses this issue. For instance, if a large business should be awarded the prime contractor of a high dollar value Federal contract, the large business is required to subcontract for goods and services from small or small-disadvantaged businesses if two or more qualified participants are located in the inner city/designated area.

F. WHITE COLLAR VS. BLUE COLLAR

The survey conducted by the researcher revealed 28 of the 32 participants indicated blue-collar industries would take most advantage of and be most beneficial to the success of this program. The researcher believes limiting the program to a either blue or white collar will partially impair the amount of economic gain the program can truly produce.

The researcher believes that this type of incentive program should earmark industries that tend to thrive or show growth within the inner city. As Max Polaner recommended to EZ administrators:

> By understanding the situation of particular businesses, it can be quickly determined whether they are likely candidates for relocation or whether the other obstacles they face are so great that no amount of incentives will overcome them. Focusing on the right kinds of firms will enable EZs to allocate resources more efficiently and improve the likelihood of attracting businesses to the Zones. [Ref. 2:p. III]

Realizing this will assist policy makers in effectively setting side Federal contracts for the inner city that are deemed most advantageous for the Federal procurement system. The Government will benefit by awarding contracts to these

competitively advantaged, best-valued, urban offerors. Many white and blue-collar industries can take advantage of a federal contracting incentive program that targets specific industries that thrive in the inner city. For instance, the competitive advantage of proximity to customers and access to markets will benefit industries such as service providers, management consulting services, construction warehousing and retailing industries. The competitive advantage of access to transportation will benefit industries specializing in manufacturing, trucking, shipping, air transport and other distributors. The availability of an eager and motivated workforce will also benefit industries. Both white and blue collar industries have indicated with proper training programs in place, inner city residents perform as well or better than their suburban contemporaries.

The Empowerment Contracting Program, to a large degree, has accomplished this effort. As mentioned in Chapter III, page 31-32, the phased implementation of the Program evaluates the program and develops any necessary changes to improve performance. The revised procedures become effective in the second phase. A two digit SIC code major group identifier designates the type of industries to which the first phase will apply. All eleven SIC code major group identifiers listed in the Executive Order were blue-collar industries with the exception of Business Services and Management Consulting Services. From the researcher's perspective, the DOC did an excellent job selecting these industries within the inner city to measure the Order's effectiveness. All of the industries listed in the Order have taken advantage of the competitive assets found in the inner city and have traditionally performed very well.

Although, the DOC has done an impressive job of identifying industries that perform well in the inner city, the researcher questions how the agency will distribute

Federal contracts in urban communities while addressing the diverse competitive advantages and disadvantages found in every inner city in America. The latest data on the Executive Order does not elaborate on who or how this will be accomplished. However, the researcher earlier recommended the roles the Federal Government should play in this Federal contracting incentive effort. State and city governments need to be empowered to determine what types of Federal contracts should allotted by the Federal Government to each inner city of America.

Determining which type of Federal contract to offer should take into account the types of resources in that community, the types of business/industries the inner city contains and wants to attract with the Federal contract preferences. The organizations or individuals who would have the best knowledge of this information would be found at the inner city level. It is recommended the community development advisory council, with direct input from CBOs, make these decisions. The advisory council forwards their findings to the city government organization (i.e., Office of the Mayor or Governor). The city government organization in turn, discusses the findings with the advisory council and upon their recommendations send the findings to the federal agency overseeing the initiative. At the Federal level, the agency is tasked with distributing the initiative's contracts to the designated areas cities based on the information obtained from participating inner cities.

G. SUMMARY

In an effort to answer the primary research question of whether Federal contracting incentives will stimulate economic development in America's inner cities, the researcher discovered patterns and trends from the surveyed material. This chapter

provided the analysis supporting the researcher's conclusions listed the Chapter IV summary. Furthermore, this chapter also provided the major strengths and weaknesses of the HUBZone Act of 1997 and the Executive Order 13005, the Empowerment Contracting Program. Based on the strong points of both initiatives, the competitive advantages and disadvantages of the inner city, and the input of many surveyed participants, the researcher made policy recommendations on how to achieve job creation and new business investment within the inner cities of America with Federal contracting incentives.

Chapter VI summarizes the study's conclusions, which were based on the findings discovered in Chapters IV and supported in Chapter V. Additionally, the researcher makes policy recommendations for employing Federal contracting incentives as a means of stimulating economic development in America's inner cities.

VI. CONCLUSIONS AND RECOMMENDATIONS

A. STUDY SYNOPSIS

Recent initiatives by U.S. policy makers to revitalize the inner cities of America have looked to the Federal procurement system as a means to stimulate economic development. Promoting economic development in terms of job creation and new business investment, is the premise of this type of initiative. President Clinton's Executive Order and Senator Bond's HUBZone bill attempt to achieve job creation and new business investment in America's inner cities via Federal contracting incentives. These incentives are designed, by policy makers to attract for-profit and not-for-profit businesses into economically distressed urban and rural communities. Both initiatives display innovative and beneficial approaches to achieving their goals; however, this study has revealed certain guideline discrepancies in both initiatives. Also, factors (social, economic, and demographic) external to these initiatives were determined to limit their ability to achieve their intended goals successfully.

Chapter V analyzed the six findings and conclusions the researcher established at the end of Chapter IV. In support of the findings, improvements to existing initiatives, as well as the creation of alternative approaches to successfully applying Federal contracts as a vehicle to creating jobs and stimulating business investment in the inner cities of America, were established. The researcher made policy recommendations based upon, conclusions from the surveyed material, the latest literature available on urban economic development policies, and the strengths found in the Empowerment Contracting Program and the HUBZone Act of 1997. The researcher believes these recommendations are the

most effective methods of using the Federal procurement system to achieve economic development in America's inner cities.

B. POLICY RECOMMENDATIONS

The researcher summarizes the following policy recommendations, which use the Federal procurement system to create jobs and stimulate business investment in America's inner cities. The recommendations are as follows:

- Since the objectives of this economic development program are creating jobs and stimulating business investment, **requiring at least 35 percent of the workforce and at least 50 percent of the contracted work be completed in the designated area** is the most immediate and effective way to meet these objectives. The HUBZone Bill addresses these requirements in a similar fashion. However, this employment requirement as stipulated by legislators may conflict with union employment provisions which many private firms are confronted with. It is suggested organized labor be invited to participate in the establishment of employment guidelines for this program so that both parties can work together to achieve their respective goals of creating jobs for American citizens.

- **In order to be qualified for contracting preferences, eligibility requirements should be limited in number and easy to comprehend**. The HUBZone Bill does an effective job of describing eligibility requirements with three, easy-to-understand conditions. The Executive Order provides too many opportunities for large and small businesses to become eligible. It provides detailed qualifying requirements that are complex and ambiguous.

This will lead to potential abuse by bidders striving to compete for the valuable contracting preference.

- **Targeting training programs to develop specific skills training needed to inner city residents, for inner city jobs should be the responsibility of both the private sector and the inner city Community Based Organizations (CBOs) along with financial assistance from the Federal Government.** This is one of the major competitive disadvantages of the inner city that needs to be addressed promptly and alleviated expeditiously. Based on their in-depth knowledge of the inner city, the CBOs can tie community development efforts to private sector investment that spells economic achievement for the inner city. In order to assist inner-city residents with achieving the necessary skills and education to ensure long-term sustainability, **an evaluation preference should be established within the guidelines of the Federal contracting incentive program that incentivizes firms to establish skills and career training program**. As employers, private firms know better than any other group what skills are needed to perform jobs within their companies. To assist in the cost of skill development and job training, the **Federal Government should establish a publicly subsidized program to allow businesses to hire and train employees from the inner city at minimal cost.**

- **Monitoring and enforcing the contracting provisions (ensuring eligibility requirements for contract preferences are met and sustained) should be**

the responsibility of the inner city CBOs. A method for measuring the effectiveness of this program should mirror the phased implementation approach as established in President Clinton's Executive Order.

- **A Community Development Advisory Council should be established in every inner city.** This Council, composed of representatives from the most influential organizations in the public and private sector, would act as the decision-making authority on a multitude of issues surrounding the implementation of a successful Federal contracting incentive program. For instance, the Council would review and decide what actions to take in overseeing the program's overall progress in terms of management, administration, implementation and enforcement.

- **The primary role of the Federal Government should be allotting funds to the state and city governments to develop a favorable business climate to attract firms.** With respect to the Government's role in sponsoring an economic development effort that uses Federal contracting incentives to lure businesses to the inner city, the **Federal Government should establish specific goals for the program with clear and concise guidelines to achieve these goals**.

- The Federal Government should **empower city government organizations in conjunction with the community development advisory council to establish eligibility requirements** for this program that are based upon the

unique competitive advantages and disadvantages found in every inner city of America.

- Since the goal of this economic development strategy is job creation and new business investment, **large and small businesses as well as white- and blue-collar industries should be eligible to compete for contracting preferences based on the number and type of industries identified as thriving or growing within the inner city.**

- **To ensure small business, Small Disadvantaged Business (SDB), and women owned business opportunities are achieved, mandatory subcontracting guidelines should be established**. These guidelines will require a large business, if awarded a high-dollar value Federal contract for inner city work, be required to subcontract at least 50 percent of its subcontracted work to small, SDB, or women-owned business if it is determined that two or more qualified firms are located in the inner city and meet the other eligibility requirements.

C. ANSWERS TO RESEARCH QUESTIONS

In order to achieve the objective of this thesis, the following primary research question was addressed:

Will Federal contracting incentives significantly impact economic development in America's inner cities?

This study has clearly indicated that an economic development strategy that uses Federal contracting preferences as a vehicle to attract businesses to the inner city will

have minimal impact on creating jobs and stimulating business investment in the inner city. The program is just another tool used by policy makers to indicate to the public that politicians are addressing their concerns about creating jobs and promoting community development. For this type of program to have a large economic impact in the inner city, it must be tied to a series of other tools that formulate an economic development strategy that makes the inner city attractive to businesses.

To further support the answer to the primary research question, the following subsidiary questions were addressed:

1. How is economic development defined?

For purposes of this research study, economic development is defined as creating jobs and promoting new or existing business investment in an area of general economic distress. The area of general economic distress for this study is considered the inner city.

2. What is a HUBZone?

As indicated in Chapter III, a HUBZone is a, Historically Underutilized Business Zone. It is an area located within a qualified metropolitan statistical area or qualified non-metropolitan area. Senator Christopher S. Bond proposed a bill to create new opportunities for growth in distressed urban and rural communities by offering Federal contracting preferences to firms that locate to a HUBZone and fulfill other eligibility requirements.

3. What is an Empowerment Zone (EZ)?

As indicated in Chapter II, EZs, formerly known as Enterprise Zones, are designated sections of low income communities in which the Federal Government hopes

to promote economic development by providing firms, tax and non-tax incentives to locate into the Zones.

4. How does the HUBZone Act (S. 208) differ from President Clinton's Empowerment Contracting Program (EO 13005)?

The researcher dedicated Chapter III to disclose the differences between the two initiatives. Both initiatives have similar economic development goals of creating jobs and spurring business investment in the inner city. The major difference between S. 208 and EO 13005 lies in the eligibility requirements a firm is required to meet in order to be considered qualified to compete for contracting preferences. Another major difference between the two initiatives was the approach each initiative used to monitor the effectiveness of its program in terms of creating jobs and stimulating business investment in the inner city.

5. What barriers do these programs face in attempting to stimulate economic development in the inner city?

Supported by inputs from surveyed participants as well as the latest literature on urban economic development issues, the researcher suggests that the higher costs of inner- city business operation, poor inner city infrastructure, and an unskilled, uneducated workforce are the primary barriers hindering firms from conducting business in the inner city. There are other barriers that hinder relocation decision-making by private firms as described in greater detail in Chapter IV.

6. What other factors, besides contracting incentives might attract businesses to relocate to the inner city?

Private firms will locate to the inner city based on the competitive advantages of the inner city. Firms will move to an area where they can anticipate a high return on

investment. The researcher believes firms will also be attracted to the inner city if policy makers establish an economic development strategy that attempts to make the inner city more attractive to firms or at least displays efforts to rid the inner city of its disadvantages.

In the beginning of Chapter V, the researcher discussed methods to overcome the competitive disadvantages found in the inner city that hinder firms from conducting business in the areas. The researcher suggested five inner-city development efforts for which policy makers should provide funding in order to diminish the competitive disadvantages found in the inner city. The five efforts are listed as follows:

- Rebuild the infrastructure of the inner city
- Revamp unusable land (brownfields)
- Upgrade training programs that offer specific skill level training for jobs earmarked for inner city industries.
- Improve public safety in the inner city
- Upgrade school systems in the inner city

7. **What roles should private sector and Community Based Organizations (CBOs) play in fostering economic development in the inner cities with Federal contracting incentives?**

As discussed in Chapter V and in this Chapter under the, "Policy Recommendations" section, targeting training programs to develop specific skills training necessary to inner-city residents for inner-city jobs should be the responsibility of the private sector and inner-city CBOs. As employers, private firms know better than any other group what skill are needed to perform jobs within their companies. CBOs, with

their in-depth knowledge of the inner city can tie community development efforts to private sector investment that spells increased economic activity for the inner city.

Additionally, monitoring and enforcing the contract provisions (ensuring eligibility requirements for contract preferences are met and sustained) should be the responsibility of the inner-city CBOs

8. What roles should the Federal Government and city government play in fostering economic development in the inner cities with Federal contracting incentives?

As indicated in Chapter V as well as in this chapter under the, "Policy Recommendations" section, the role of the Federal Government in promoting an economic development program in America's inner cities with Federal contracting incentives should be to establish a strategy of specific goals and minimal guidelines. Thus, the Federal Government should develop an *umbrella strategy*. As noted in strategic management literature, an *umbrella strategy* sets out broad guidelines and leaves the specifics to others down in the organization. "Such organizations can be effective only if their implementers are allowed to be formulators, because it is people way down in the hierarchy who are in touch with the situation at hand and have the requisite technical expertise." [Ref. 73]

The Federal Government should empower the city government organizations to implement this program and achieve the specific goals of the program based upon the unique competitive advantages and disadvantages found in each inner city.

The Federal Government should financially assist private firms and inner-city CBOs in the cost of skill development and job training. The Government should

establish a publicly subsidized program to allow private firms and CBOs to hire and train employees from the inner city for inner-city industries at minimal cost.

Determining which type of Federal contract to offer for award in America's inner cities should take into account the types of resources found in the inner city, the type of businesses/industries the inner city contains and wants to attract with the Federal contract preferences. The organizations with the best knowledge of this information will be found at the inner city level. This process will heavily involve the community development advisory council, which the researcher previously suggested be established, inner city CBOs, and city government organizations.

It is recommended the community development advisory council, with direct input from CBOs, make these decisions. The advisory council will forward their findings to the city government organization. The city government organization in turn discusses the findings with the advisory council and upon its recommendations, sends the findings to the Federal agency overseeing this effort. The Federal agency is then tasked with distributing the Federal contracts to the designated areas based on the information obtained from participating inner cities. This process will ensure Federal contracts are used in the most effective and efficient ways in America's inner cities.

D. AREAS FOR FURTHER RESEARCH

1. The effects on organized labor unions of efforts to promote economic development in urban and rural communities with Federal contracting preferences and set-asides.

2. Promoting economic development in the rural communities of America with Federal contracting incentives.

APPENDIX. LIST OF PHONE INTERVIEWS

Timothy Foreman, Procurement Specialist, Senate Committee on Small Business. Washington D. C. April 2, 1997.

Ursula Powidzki, Managing Director of Baltimore Advisors, Initiative for a Competitive Inner City, Baltimore, Maryland. April 9, 1997

Michael McHale, Procurement Analyst, Small Business Administration (SBA), Washington D.C. April 10, 1997.

Karen Salmon, Executive Assistant to the Mayor of Chicago. April 25, 1997.

Sandra Newman, CEO, Raritan Container Company, New Brunswick, New Jersey. May 2, 1997.

Fabio Sampoli, Senior Vice President, The Greater New Haven Chamber of Commerce, New Haven, Connecticut. May 2, 1997.

Pamela Loprest, Project Manager, The Urban Institute, Washington D.C. May 2, 1997.

Bertram C. Willis, Group Director, Campbell Soup Company, Camden, New Jersey. May 6, 1997.

David Lawrence, Executive Vice President, Recom Corporation, May 7, 1997

Tom Dalfo, Project Manager, Cooper's Ferry Development Association, Camden, New Jersey. May 8, 1997

Amrina Lavirdy, Executive Director, Latin American Management Association, Washington D. C. May 9, 1997.

Anthony W. Robinson, President, Minority Business Enterprise Legal Defense Education Fund, Inc., Washington D. C. May 13, 1997.

Glynn J Loope, Executive Director, The Allegheny Highlands Economic Development Authority, Covington. Virginia, May 14, 1997.

Dr Donald Holbrook, Executive Director, Red Wing Port Authority, Red Wing, Minnesota May 14, 1997.

Roger Mody, President and CEO, Signal Corporation, Fairfax, Virginia. May 15, 1997.

Peter Enrich, Associate Professor, Northeastern University, Department of Economics. May 16, 1997.

Mike Andrews, Executive Director, Office of the Governor of Alaska, Alaska Human Resource Investment Council. May 19, 1997.

Jennifer Barton, Project Manager, Lockheed Martin Communication Systems, Camden, New Jersey. May 19, 1997.

Bob Tannenwald, Senior Economist, Federal Reserve Bank of Boston. May 21, 1997.

Barry Corona, President and CEO, Production Products Manufacturing & Sales, Inc. St. Louis, Missouri. May 28, 1997.

Brent Evans, Executive Vice President, Mid-Tech Corporation, St. Louis, Missouri. May 29, 1997.

Jennifer Gilbert, Assistant General Counsel, The Community Builders, Inc., Boston, Massachusetts. May 30, 1997.

Samuel Carradine, Executive Director, National Association of Minority Contractors. June 2, 1997.

Alicia Diaz, Assistant Director of Grant Management, Office of the Mayor of Detroit, Michigan. June 2, 1997.

Leslie Papke, Associate Professor, Michigan State University, Department of Economics. June 2, 1997.

David Triesch, Director of Economic Development Practice, Fuldin company, Cambridge, Missouri. June 4, 1997.

David Littman, First Vice President and Senior Economist, Comerica Bank, Detroit, Michigan. June 4, 1997.

Paul Chann, Procurement Center Representative, SBA, San Francisco, California. June 9, 1997.

Anne S. Habiby, Director of Research and Communication, Initiative for a Competitive Inner City, Boston, Massachusetts. June 10, 1997

Tom Kolis, Small Business Specialist, NASA AMES Research Center, Moffet Field, California. June 10, 1997.

Austin C. Fitts, CEO, Hamilton Securities Group. Washington DC., July 8, 1997

Barry M. Rubin, Associate Dean, Indiana Unviversity, Bloomington, IN., and advisor to the Economic Analysis Unit of the Indiana Department of Commerce. July 11, 1997.

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